Jurisdictional Statement

No. 81-1613

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

MEMPHIS BANK & TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE,

Appellees.

On Appeal From The Supreme Court Of Tennessee

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

Whether the Tennessee bank tax imposed by Section 67-751 of the Tennessee Code Annotated is in violation of 31 U.S.C. § 742 (which exempts from taxation by state or local authorities interest earned on obligations of the United States) and 12 U.S.C. §§ 2055, 2079 and 2134 (which contain similar exemptions for income from the obligations of federal instrumentalities) when the amount of the tax is measured by the bank's net earnings, defined to include interest on obligations of the United States and its instrumentalities, there being excluded from such definition interest earned on bonds and other obligations of the State of Tennessee and its political subdivisions, and there being a separate franchise tax and a separate corporate excise tax imposed on all corporations, including banks, doing business in Tennessee.

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IN THE

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OCTOBER TERM, 1981

No.

MEMPHIS BANK & TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE,

Appellees.

On Appeal From The Supreme Court Of Tennessee

JURISDICTIONAL STATEMENT

Appellant, Memphis Bank & Trust Company[1] ("Memphis Bank & Trust") appeals from a final judgment of the Supreme Court of Tennessee, entered November 30, 1981, upholding the validity of a Tennessee statute, Tenn. Code Ann. § 67-751, which Memphis Bank & Trust had challenged on the ground

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[1] Appellant Memphis Bank & Trust is a wholly owned subsidiary of Memphis Trust Company, a holding company. Other subsidiaries of the holding company are Central Guardian Life Insurance, Memphis Trust Insurance Agency, Inc., and Arrow Business Interiors.

that, as applied to it, the statute violates the laws of the United States and is repugnant to the Constitution.

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee, reported at 624 S.W.2d 551 (Tenn. 1981), is reproduced in the Appendix hereto, pp. 3a-9a.

The Order On Judgment entered January 9, 1981, by the Chancery Court of Shelby County, Tennessee, Part III, from which the appeal to the Supreme Court of Tennessee was taken, is not reported, but is reproduced in the Appendix, pp. 15a-17a. That Order On Judgment incorporated by reference the oral opinion of the court rendered December 19, 1980. The transcript of that opinion is reproduced in the Appendix, pp. 19a-26a.

JURISDICTION

The final judgment of the Supreme Court of Tennessee, Appendix, p. 1a, was entered November 30, 1981. That judgment upheld the validity of a Tennessee statute, Tenn. Code Ann. § 67-751, challenged by Memphis Bank & Trust as being in violation of the laws of the United States and repugnant to the Constitution. Notice of Appeal, Appendix, pp. 11a-13a, was filed in the Supreme Court of Tennessee on February 5, 1982. The jurisdiction of this Court is invoked under 28 U.S.C.§ 1257(2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

United States Constitution, Article VI, Clause 2:

This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every

State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

United States Constitution, Article I, Section 8, Clause 2:

Section 8. The Congress shall have the Power . . . To borrow money on the credit of the United States . . . .

Tennessee Code Annotated § 67-751 [2]

Bank Tax

Excise tax on bank earnings — Rate. — There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such

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[2] The act of the Tennessee Legislature (1977 Tenn. Pub. Acts, ch. 140), which is codified as Tenn. Code Ann. §§ 67-751, 67-752, 67-753, and which contains a lengthy preamble, is set out in the Appendix, pp. 35a-37a.

bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject.

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31 U.S.C. § 742

Exemption From Taxation

Except as otherwise provided by law,[3] all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

The following statutes are also involved in this case and are set out verbatim in the Appendix, pp. 33a-34a: 12 U.S.C. §§ 2055, 2079, and 2134.

STATEMENT OF THE CASE

Memphis Bank & Trust brought this action in the Chancery Court of Shelby County, Tennessee, Part III, on June 27, 1979, to recover $56,696.81 in taxes paid under protest to appellees Riley C. Garner, Shelby County Trustee, and Glenn E. Foster, Treasurer of the City of Memphis. The taxes in question,

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[3] The phrase "Except as otherwise provided by law" appears in 31 U.S.C. § 742, but does not appear in the official Statutes at Large, Section 3701 of the Revised Statutes of the United States. The phrase was inserted by the Revisers in the 1926 general revision of the Code. *See* Codification Note to 31 U.S.C. § 742. Title 31 has not been enacted as law.

covering the years 1977 and 1978, had been assessed pursuant to the so-called Tennessee bank tax, found at Section 67-751 of the Tennessee Code Annotated, set out at pp. 3-4, above.

Under the terms of the bank tax, each bank doing business in Tennessee is required to pay to local governments of the State a tax of 3% of the bank's net earnings for the preceding fiscal year, less a portion of certain ad valorem property taxes paid for that year. The term "net earnings" is defined for purposes of the bank tax to include interest on obligations of the United States and its instrumentalities, as well as interest on bonds and other obligations of states other than Tennessee, but to exclude interest on obligations of Tennessee and its political subdivisions.[4] In addition to the bank tax, Memphis Bank & Trust is subject to and annually pays the Tennessee corporate franchise tax (Tenn. Code Ann. §§ 67-2901 *et seq.*, Appendix, pp. 39a-40a), and the Tennessee corporate excise tax (Tenn. Code Ann. §§ 67-2701 *et seq.*, Appendix, pp. 41a-43a).

In its Complaint, as amended, Memphis Bank & Trust alleged that the bank tax, as applied to it, was in violation of 31 U.S.C. § 742 ("the federal exemption statute") and 12 U.S.C. §§ 2055, 2079 and 2134 ("the federal agency exemption statutes"), and thus was unconstitutional under the Supremacy Clause of the United States Constitution. The Honorable William M. Leech, Jr., Attorney General for the State of Tennessee, intervened as a defendant and counterclaimed seeking,

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[4] The bank tax (Tenn. Code Ann. § 67-751) provides that "net earnings shall be calculated . . . as prescribed by chapter 27 of title 67." In that chapter and title at § 67-2704 the term "net earnings" is defined as "federal taxable income" (which includes interest on obligations of the United States and its instrumentalities, but does not include interest on obligations of a state or its political subdivisions; 26 U.S.C. §§ 61, 63 and 103, 31 U.S.C. § 742a), with certain adjustments. Under the adjustments, interest earned on the obligations of states other than Tennessee and their political subdivisions is added to "federal taxable income" to arrive at "net earnings."

inter alia, a declaratory judgment that the bank tax, as applied to Memphis Bank & Trust, was valid.

After the Attorney General intervened, the parties entered into a Stipulation, Appendix, pp. 27a-32a, and submitted the case on cross-motions for summary judgment. The parties agreed in the Stipulation that the bank tax was an intangible personal property tax; that, as applied to Memphis Bank & Trust, the tax was based on interest earned on certain federal obligations (U.S. Treasury Notes, U.S. Treasury Bills, and obligations of Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives); and that, if the interest earned on such federal obligations was excluded from the computation, Memphis Bank & Trust would have no liability under the bank tax for the years in question.

The Chancery Court granted Memphis Bank & Trust's motion for summary judgment, finding that the bank tax violates 31 U.S.C. § 742 and 12 U.S.C. §§ 2055, 2079 and 2134, and is thus unconstitutional under the Supremacy Clause of the United States Constitution, insofar as it includes in the measure of the tax interest earned on obligations of the United States and its instrumentalities. Appendix, pp. 15a-16a, 20a-25a.

The appellees herein appealed to the Supreme Court of Tennessee which reversed and held that the Tennessee bank tax does not violate the federal exemption statute (31 U.S.C. § 742) or the federal agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134). Appendix, pp. 4a-9a. In reaching that conclusion, the court held that the bank tax is a local bank excise tax and not a direct tax on property; that the bank tax falls within the exceptions provided in the federal exemption statute for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations," despite the fact that banks already pay the corporate franchise tax and the general corporate excise tax in Tennessee; and that the bank tax is not discriminatory because it does not treat federal obligations as

"special or direct objects of taxation," even though the bank tax includes in its measure income from federal obligations while excluding income from obligations of the State of Tennessee. Appendix, pp. 4a-9a. In sum, the Supreme Court of Tennessee found "nothing in either . . . 31 U.S.C. § 742, or . . . 12 U.S.C. §§ 2055, 2079 and 2134, or in the federal constitution which prohibits the measure of the bank excise tax by its federal taxable income, *including interest on federal obligations*." Appendix, p. 8a; emphasis added.

THE QUESTION IS SUBSTANTIAL

More than 150 years ago this Court decided that obligations of the federal government are immune from state taxation. *Weston* v. *City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829). More recently, this Court explained that "[t]his rule, aimed at protecting the borrowing power of the United States from state encroachment, was derived from the 'Borrowing' and 'Supremacy' Clauses of the Constitution, and the constitutional doctrines announced in McCulloch v. State of Maryland." *Society for Savings in the City of Cleveland* v. *Bowers*, 349 U.S. 143, 144 (1955) (footnote omitted). The rule, currently embodied in the federal exemption statute (31 U.S.C. § 742) and the related federal agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134), provides crucial protection to the continuing ability of the federal government to implement its borrowing power. Tennessee's bank tax is an attempt to circumvent this rule.

As originally enacted, the federal exemption statute provided simply that obligations of the United States "shall be exempt from taxation by or under State or municipal or local authority." Act of February 25, 1862, ch. 33, § 2, 12 Stat. 346. In 1959,

however, the statute was amended by adding the following sentence:

> "This exemption extends to *every form* of taxation that would require that either the obligations or the interest thereon, or both, be considered, *directly or indirectly*, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes." 31 U.S.C. § 742; emphasis added.

By thus making the statute more specific in its prohibition, the Congress sought to foreclose attempts by the states to sidestep the federal exemption rule. S. Rep. No. 909, 86th Cong., 1st Sess. ____, *reprinted in* 1959 U.S. Code Cong. & Ad. News 2769, 2773-74.

More specifically, the amendment was aimed at an attempt by the state of Idaho, and similar attempts by other states, to evade the exemption rule by taxing federal obligations only indirectly. *See Public Debt Ceiling and Interest Rate Ceiling on Bonds: Hearings Before the House Committee on Ways and Means*, 86th Cong., 1st Sess. 69-72 (1959)(Statement of Hon. Robert B. Anderson, Secretary of Treasury). Like the Tennessee bank tax involved here, the Idaho tax statute was defended on the ground that income from federal obligations was not the object of the tax, but was merely a part of the measure of the tax. In testimony before the House Ways and Means Committee, Secretary of Treasury Robert B. Anderson dismissed this defense as "a distinction of words which is without substance." *Id.* at 71. He further testified that the simplest solution to the problem posed by statutes such as the Idaho statute would be to "clarify" the exemption by "expressly exempting" federal obligations and the interest on them from state and local taxing authority. *Id.* Stressing the need for such clarification, Secretary Anderson stated that "[i]f positions such as Idaho has held are adopted by other States the resulting taxation . . . could have undesirable effects on Treasury financing operations." *Id.* at 72.

The Secretary's admonition is as pertinent today as it was some twenty years ago. Indeed, if the recently-enacted Tennessee bank tax is adopted by other states — as it may well be in the current economic climate as states seek additional revenue sources — the Treasury of the United States will surely suffer. The federal exemption statutes were designed to prevent that result.

The Tennessee bank tax, as applied to Memphis Bank & Trust, clearly violates 31 U.S.C. § 742. The bank tax uses in its computation the earnings from obligations of the United States and its instrumentalities.[5] See n.4, p. 5, *supra*. The tax does not fit within any of the exceptions provided in 31 U.S.C. § 742 for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations."

First, the bank tax is not a "nondiscriminatory franchise tax." Indeed, the bank tax is not a franchise tax at all. Although the Supreme Court of Tennessee pointed out the long-standing position of Tennessee courts that the state's franchise tax and its general corporate excise tax are taxes for the privilege of doing business and exercising the corporate franchise in the state, the bank tax is in the nature of an excise tax only in the manner of its computation and is not exacted for the privilege of doing business. It should be noted that the state franchise tax, which is so denominated (Tenn. Code Ann. § 67-2901, Appendix, p.

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[5] In reaching its conclusion that the bank tax does not violate the federal exemption statutes, the Supreme Court of Tennessee, relying on decisions predating the 1959 amendment to 31 U.S.C. § 742, upheld the bank tax as not a "special or direct" tax on the income from federal obligations, suggesting that it taxed such income only indirectly. Appendix, p. 7a. The 1959 amendment explicitly prohibits any form of tax which considers federal obligations or the income therefrom "directly or indirectly, in the computation of the tax." 31 U.S.C. § 742.

39a) and separately applies to banks as well as corporations generally, is by its own terms a privilege tax imposed for the privilege of engaging in business in corporate form in Tennessee (Tenn. Code Ann. § 67-2902, Appendix, p. 39a). This franchise tax is measured by the issued and outstanding stock, surplus and undivided profits of each corporation. Tenn. Code Ann. § 67-2903, Appendix, p. 40a. The general corporate excise tax, which also separately applies to banks as well as corporations generally, is codified separately in Chapter 27 of the Taxes and Licenses Title. The general corporate excise tax is measured by net earnings, and is, like the corporate franchise tax, by its own terms a privilege tax. Tenn. Code Ann. §§ 67-2702, 67-2704, Appendix, pp. 41a-43a.

The Tennessee bank tax contains no language indicating that the tax is in any way predicated on the privilege of doing business or exercising the corporate franchise in Tennessee. Tenn. Code Ann. § 67-751. This tax, imposed on banks which are also subject to the franchise tax and to the general corporate excise tax, is not a franchise tax, but is in fact a tax on income. Although the bank tax is imposed on banks doing business in Tennessee, "doing business" simply provides the basis for Tennessee's jurisdiction to impose the tax and does not make the bank tax a franchise tax.

In any event, the Tennessee bank tax is discriminatory and therefore cannot fall within the exception of 31 U.S.C. § 742 for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations." Under Tennessee's bank tax, income from obligations of the United States and its instrumentalities is taxed, while income from obligations of Tennessee and its political subdivisions is not taxed. The Tennessee bank tax thus conflicts directly with the principles applied by this Court in cases such as *Schuylkill Trust Co.* v. *Common-*

wealth of Pennsylvania, 296 U.S. 113 (1935). The determination of whether a corporate tax statute discriminates against obligations of the United States depends on whether the amount of the tax remains the same regardless of the character or make-up of the corporation's assets. *Werner Machine Co.* v. *Director of Division of Tax*, 350 U.S. 492, 493-494 (1956). Here, the amount of the bank tax will vary depending on the extent to which a bank holds federal obligations as opposed to Tennessee obligations. Thus, the higher the proportion of assets invested in obligations of the State of Tennessee and its political subdivisions, the lower the amount of bank tax. The practical effect of this discrimination is to discourage a bank from investing in federal obligations. The Tennessee bank tax thus obstructs the borrowing power of the United States.

Lastly, the Tennessee bank tax does not fit within the exceptions provided in the federal exemption statute because it clearly is not a nonproperty tax in lieu of a nondiscriminatory franchise tax. Not only was the bank tax stipulated below to be an intangible personal property tax, but the statute itself refers to the tax as a tax on "intangible personal property" and then provides that "in lieu of the assessment according to the value and taxation of its intangible personal property," a tax will be imposed on earnings.[6] Tenn. Code Ann. § 67-751. Thus, the bank tax is clearly not a nonproperty tax since it is specifically imposed as a tax on or in lieu of a tax on intangible personal

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[6] In the preamble to the act which enacted the bank tax (1977 Tenn. Pub. Acts, ch. 140; Appendix, pp. 35a-37a), the Tennessee Legislature stated that it was acting under the provision of the Tennessee Constitution art. 2, § 28, which empowers it to classify and assess intangible personal property. Furthermore, the act is codifed in the same title and chapter as other direct taxes on corporate and business property (Title 67, Taxes and Licenses, Chapter 7, Assessment of Corporate and Business Property), and provisions for payment and collection of the tax are the same as for other property taxes (Tenn. Code Ann. §§ 67-759, 67-760, 67-1101, 67-1104).

property. Moreover, Memphis Bank & Trust is subject to and annually pays the Tennessee franchise tax imposed by Tenn. Code Ann. § 67-2901, *et seq*. Therefore, the bank tax is clearly not in lieu of the franchise tax since Memphis Bank & Trust has to pay both.

The bank tax, as applied to Memphis Bank & Trust, also violates the specific federal agency exemption statutes. Under 12 U.S.C. § 2055, Appendix, p. 33a, the obligations issued by federal land bank associations "shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal and local taxation." Obligations of federal intermediate credit banks are accorded identical treatment under 12 U.S.C. § 2079, Appendix, p. 33a. Similarly, 12 U.S.C. § 2134, Appendix, pp. 33a-34a, establishes banks for cooperatives as instrumentalities of the United States and, as such, obligations issued by them are exempt "both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial or local taxing authority." The plain language of these statutes leaves no room for a state or local tax, such as the Tennessee bank tax, on income from obligations of the specified federal instrumentalities. Indeed, these statutes are broader than 31 U.S.C. § 742, since they contain no exceptions to the general exemption rule.[7]

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[7] Although the specific agency exemption statutes do not include the language added in 1959 to Section 742 by Public Law 86-346, that amendment was intended as a clarification of the existing exemption statute and did not broaden the scope of the exemption. *See Public Debt Ceiling and Interest Rate Ceiling on Bonds: Hearings Before the House Committee on Ways and Means*, 86th Cong., 1st Sess. 69-72 (1959) (Statement of Hon. Robert B. Anderson, Secretary of Treasury).

The issues presented by this appeal are significant and potentially far reaching. Tennessee is not the only state that in recent years has attempted to circumvent the federal exemption statute and the federal agency exemption statutes. Indeed, in at least five states, such attempts have been challenged in state court, and those challenges have produced conflicting results.[8] Additional efforts to tax federal obligations can be anticipated, particularly as the states assume increasing economic responsibility for their citizens. Yet, the operation of the federal government — already heavily dependent upon the borrowing power conferred by the Constitution — must go forward. Interference by the states with the borrowing power, by taxing obligations of the federal government and its instrumentalities, must not be permitted. Plenary consideration of the question by this Court, with briefs on the merits and oral argument, is clearly warranted.

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[8] *See Bartow County Bank* v. *Bartow County Board of Tax Assessors*, No. 37868 (Ga., filed January 6, 1982) (bank share tax based on net assets of bank and deemed to be imposed on shareholders held under the "Except as otherwise provided by law" language of 31 U.S.C. § 742 not to violate that statute by reason of earlier version of 12 U.S.C. § 548); *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981)(Rhode Island Business Corporation Tax, which includes in gross receipts interest and sales proceeds from federal securities, held to violate 31 U.S.C. § 742 where separate Corporate Franchise Tax also imposed); *Bank of Texas* v. *Childs*, 615 S.W.2d 810 (Tex. Civ. App. 1981)(substantially same as *Bartow County Bank* above); *Montana Bankers Association* v. *Montana Department of Revenue*, 580 P.2d 909 (Mont. 1978)(where Montana Bank Shares Tax provides for inclusion of value of federal obligations in computing liability, bank held entitled to deduction for value of such obligations under 31 U.S.C. § 742); *Reuben L. Anderson-Cherne, Inc.* v. *Commissioner of Taxation*, 226 N.W.2d 611 (Minn. 1975) (excise tax upon corporations specifically for privilege of doing business and measured by net income, including interest on federal obligations, held nondiscriminatory franchise tax under 31 U.S.C. § 742, where there was no other corporate franchise tax).

CONCLUSION

For these reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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Appendix

IN THE SUPREME COURT OF TENNESSEE
AT JACKSON

MEMPHIS BANK AND TRUST COMPANY,
Plaintiff-Appellee,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

and

WILLIAM M. LEECH, JR.,
Attorney General for the State of Tennessee,
Defendants-Appellants.

SHELBY EQUITY

REVERSED AND DISMISSED;
REMANDED FOR COSTS

JUDGMENT
FILED
November 30, 1981

This cause coming on to be heard upon a transcript of the record from the Chancery Court of Shelby County, briefs of Appellants, briefs of Appellee, and argument of counsel, upon consideration whereof the Court is of opinion that in the judgment of the Court below there is reversible error.

In accordance with the opinion of the Court filed herein, it is, therefore, ordered and adjudged by this Court that the judgment of the Court below be reversed and the suit dismissed, and the cause be remanded to the Chancery Court of Shelby County for the collection of the costs of the Court below, for all of which let procedendo issue.

Costs incident to this appeal are taxed to the appellee, Memphis Bank & Trust Company, for which execution may issue if necessary.

11/30/81

IN THE SUPREME COURT OF TENNESSEE
AT JACKSON

MEMPHIS BANK AND TRUST COMPANY,
Plaintiff-Appellee,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

and

WILLIAM M. LEECH, JR.,
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Defendants-Appellants.

SHELBY EQUITY

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Opinion

REVERSED AND DISMISSED;
REMANDED FOR COSTS.

HARBISON, C.J.

Appellee paid under protest and sought recovery of the local bank excise tax for the years 1977 and 1978. It contended that the taxing statute was unconstitutional and unenforceable insofar as it required inclusion of interest on federal obligations in measuring the tax. The Chancellor allowed recovery, holding that the state statute was contrary to federal exemption statutes, such as 31 U.S.C. § 742, and to the Supremacy Clause of the United States Constitution.[1] Finding no such conflict, we reverse and dismiss the action.

The decision of the Chancellor was rendered before release of the opinion of this Court in *Commerce Union Bank of Chattanooga* v. *State Board of Equalization*, 615 S.W.2d 151 (Tenn. 1981). He apparently construed the statutes in question, T.C.A. §§ 67-751 to 763, as imposing a tax upon intangible property held by state banks. To the extent that such assets consisted of federal obligations, he found that controlling federal statutes required exemption of these obligations and interest thereon. Although he did not hold the taxing statute unconstitutional in its entirety, the effect of exempting income from federal obligations was to relieve the taxpayer entirely from the subject taxes for the two years in question.

In the case of *Commerce Union Bank of Chattanooga* v. *State Board of Equalization*, *supra*, this Court held that the bank tax enacted in 1977 is not a property tax but is purely an excise tax based upon net earnings as computed under the general corporate excise tax law of the state, T.C.A. §§ 67-2701 to 2732.

The general excise tax is levied upon net earnings "defined as federal taxable income" subject to certain deductions and exemptions. T.C.A. § 67-2704. It has long been held in this state that the general corporate excise and franchise taxes are not property taxes but are taxes laid upon the privilege of doing business in corporate form

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[1] U.S. Const. art. VI, § 2.

and of exercising the corporate franchise in this state. In *American Bemberg Corp.* v. *Carson*, 188 Tenn. 263, 272, 219 S.W.2d 169, 173 (1949), the Court said:

> ". . . the excise and franchise taxes exacted for the privilege of exercising their corporate franchises and doing business in Tennessee, represent a single coordinate scheme of taxation and are to be considered together in determining their burden on complainants and the effect on their constitutional rights."

The constitutionality of the state franchise tax was upheld in the case of *Corn* v. *Fort*, 170 Tenn. 377, 95 S.W.2d 620 (1936), and that of the excise tax in *Bank of Commerce & Trust Co.* v. *Senter*, 149 Tenn. 569, 260 S.W. 144 (1923).

The present state franchise and excise taxes were enacted in 1976. Their predecessors, however, were enacted much earlier and were subjected to the same general attack as is made by the taxpayer in the present case. In *General Securities Co.* v. *Williams*, 161 Tenn. 50, 29 S.W.2d 662 (1930), the 1923 corporate excise tax was challenged because in its measure there was no exclusion of income from federal obligations. While the Court found that the record failed adequately to present the issue, nevertheless it stated:

> "In any event, however, we are unable to see that chapter 21 of the Acts of 1923 is invalid for the reasons urged. We are referred to the case of MacAllen Company v. Massachusetts, 279 U.S., 620, 73 L. Ed., 875. This case is exceptional in its facts. The State of Massachusetts formerly exempted the income from securities of the class here in consideration from the earnings of corporations by which an excise tax was measured. By amendment to previous legislation, the State of Massachusetts deliberately declared that the income from such securities should be included in the aggregate of corporate earnings measuring the excise tax. The amendatory legislation was stricken down because, as the court said, it was 'adopted, as though it had been so declared in precise words, for the very purpose of subjecting these securities *pro tanto* to the burden of the tax.'
>
> "We do not understand that the court overruled *Flint* v. *Stone Tracy Company*, 220 U.S., 107, 55 L. Ed., 389. That case and preceding cases held that a tax lawfully imposed upon the exercise of corporate privileges within the taxing power might

> be measured by income from the property of the corporation although a part of such income was derived from non-taxable property. Chapter 21 of the Acts of 1923 was not aimed at the income from non-taxable securities and any resulting burden thereby was fortuitous and incidental." 161 Tenn. at 54, 29 S.W.2d at 663.

In the case of *National Life & Accident Insurance Co.* v. *Dempster*, 168 Tenn. 446, 79 S.W.2d 564 (1935), the Court expressly held that inclusion of interest from federal obligations in computing the corporate excise tax did not invalidate the tax or the statute imposing it. The Court said:

> "The tax imposed by the act is a privilege tax and not a direct tax on property. *Bank of Commerce & Trust Co.* v. *Senter*, 149 Tenn., 569, 260 S.W., 144. The rule seems to be settled that an excise tax statute is not unconstitutional solely because there is included in the income of the taxpayer, by which the tax is measured, interest from tax-free bonds, when such inclusion is incidental and fortuitous.. . .
>
> "The legislation here under consideration discloses only that the state of Tennessee has sought, in good faith, to conform its scheme of taxation of corporations to a permitted method. By the act in question it has adopted a form of privilege tax on corporations measured by their net income, without any form of discrimination as to the sources of the income included in the measure, differing in this respect in no material way, from a similar tax upheld in *Flint* v. *Stone Tracy Co.*, 220 U.S., 107, 31 S. Ct., 342, 55 L. Ed., 389, Ann. Cas. 1912B, 1312, and in *Educational Films Corp.* v. *Ward*, 282 U.S., 379, 51 S. Ct., 170, 75 L. Ed., 100, 71 A.L.R., 1226." 168 Tenn. at 454-55, 79 S.W.2d at 567.

In *Nashville Trust Company* v. *Evans*, 195 Tenn. 205, 258 S.W.2d 761 (1953), the Court held that neither the corporate franchise tax nor the corporate excise tax was a tax upon obligations of the United States or of the income therefrom but that both were non-discriminatory privilege taxes imposed upon all commercial corporations doing business in the state and imposed upon the privilege of engaging in business in corporate form. The predecessor to the present federal exemption statute, 31 U.S.C. § 742, was considered

in that case and held not to invalidate in any respect the state franchise and excise tax statutes.

It therefore appears that most of the issues raised by appellee in the present case have been previously considered. When the tax in question is viewed as an excise tax, as this Court has held that it must be, it becomes clear that many of the issues raised by the taxpayer have been settled contrary to its contentions by both state and federal courts.

The federal exemption statute, 31 U.S.C. § 742, was amended in 1959 and the second sentence quoted below was added:

> "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or Municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

In our opinion, the exception contained in the last part of the second sentence is clearly applicable to the excise tax here under consideration. The tax is not discriminatory in the sense used in the federal statutes. It does not single out federal obligations or the interest therefrom or in any other way treat them as special or direct objects of taxation as occurred in *Miller* v. *City of Milwaukee*, 272 U.S. 713 (1927), or *MacAllen Company* v. *Massachusetts*, 279 U.S. 620 (1929). The present tax is clearly a "nonproperty" tax and is a corporate privilege tax. We do not find persuasive the taxpayer's argument that the term "franchise" tax used in the federal statute excludes a general corporate "excise" tax. As noted previously, in this state, the two terms have frequently been used interchangeably as both being taxes upon the exercise of a corporate franchise within the state. It is well established that a corporate franchise created by a state can legitimately be taxed and that the tax may be imposed without any deduction for federal securities or interest thereon. *Werner Machine Company* v. *Director of Division of Taxation*, 350 U.S. 492 (1956); *Tradesmens National Bank of Oklahoma City* v. *Oklahoma Tax*

Commission, 309 U.S. 560 (1940); *Pacific Company* v. *Johnson*, 285 U.S. 480 (1932); *Educational Films Corp. of America* v. *Ward*, 282 U.S. 379 (1931); *Flint* v. *Stone Tracy Company*, 220 U.S. 107 (1911). In these and many other cases the terms "franchise" and "excise" tax are used interchangeably. We are of the opinion that the local bank excise tax here under consideration is the kind of tax referred to in the federal exemption statute.

We likewise find unpersuasive the contention of the taxpayer that the present tax is "discriminatory" because it is levied only upon banks. The history of the statute is well developed in the record in the present case. As stated in the statute itself, it is in lieu of a tax upon intangible personal property of banks, and it is a successor to a former tax upon shares of banking institutions.

It is well settled that banking institutions are accorded privileges and rights not granted to other commercial corporations and that they therefore may be classified separately by the General Assembly for purposes of taxation and regulation. *Bank of Commerce & Trust Co.* v. *Senter*, 149 Tenn. 569, 587-88, 260 S.W. 144, 149 (1923).

We find nothing in either the general exemption statute relied upon by appellee, 31 U.S.C. § 742, or the particular exemption statutes pertaining to certain types of obligations, 12 U.S.C. §§ 2055, 2079 and 2134, or in the federal constitution which prohibits the measure of the bank excise tax by its federal taxable income, including interest on federal obligations. One of the cases principally relied upon by appellee, *Montana Bankers Association* v. *Montana Department of Revenue*, 580 P.2d 909 (Mont. 1978), involved a direct property tax upon shares of stock in banking corporations. The tax under consideration there was not in any sense an excise or privilege tax upon the exercise of a corporate franchise such as that involved in the instant case. Likewise the case of *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981), appears to have involved a general income or gross receipts tax, and the Court stated that the tax clearly was "not a franchise tax." 429 A.2d at 449.

The judgment of the trial court is reversed and the suit is dismissed at the cost of appellee. The cause will be remanded to the trial court for collection of costs accrued there.

/s/ WILLIAM J. HARBISON
William J. Harbison, C. J.

Fones, Cooper, Brock and Drowota, JJ., concur.

IN THE SUPREME COURT OF TENNESSEE

Shelby Equity No. 6

MEMPHIS BANK AND TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

Appellees,

and

WILLIAM M. LEECH, JR.,
Attorney General for the State of Tennessee,

Intervening Appellee.

Notice Of Appeal To The
Supreme Court Of The United States
(Date Filed: February 5, 1982)

NOTICE is hereby given that MEMPHIS BANK & TRUST COMPANY, the Appellant above-named, hereby appeals to the Supreme Court of the United States from the Final Judgment of the Supreme Court of the State of Tennessee, entered in this action on November 30, 1981.

The Supreme Court of Tennessee construed the Tennessee Bank Tax of sections 67-751 to 67-763 as a local bank excise tax in lieu of an intangible personal property tax. The Court held that the measure of this Bank Tax by federal taxable income, including the interest on federal obligations, did not violate the Federal Exemption Statute, 31 U.S.C. § 742 (1976), or the specific Federal Agency Exemption Statutes, 12 U.S.C. § 2055 (1976), 12 U.S.C. § 2079 (1976), 12 U.S.C. § 2134 (1976), which forbid state and local authorities from taxing federal obligations. The Court held the Bank Tax was not discriminatory on the basis that it was levied only on banks nor on the basis that the computational base of the tax exempts state obligations from taxation but includes federal obligations and the interest thereon

as taxable. The Court concluded that this local bank excise tax fell within the exceptions to the Federal Exemption Statute, 31 U.S.C. § 742 (1976), for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations. . . ."

The Appellant hereby appeals to the Supreme Court of the United States the judgment of the Supreme Court of Tennessee which reversed the judgment of the Chancery Court of Shelby County and remanded the cause for costs and which sustained the validity of the Bank Tax against Appellant's challenge that the inclusion of interest on federal obligations in the computational base of the tax violated federal law.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

/s/ DAVID C. SCRUGGS
David C. Scruggs

/s/ ANDREW H. RAINES
Andrew H. Raines

COBB, EDWARDS, NICHOL, WOODALL & KELLY
900 Memphis Bank Building
Memphis, TN 38103
(901) 525-6781

Attorneys for Appellant

CERTIFICATE OF SERVICE

I, David C. Scruggs, do hereby certify that a copy of the foregoing Notice of Appeal to the Supreme Court of the United States has been served on Appellees by forwarding a copy thereof to:

J. MINOR TAIT, JR.
Assistant County Attorney
MARY MARGARET WEDDINGTON
P.O. Box 3160
Memphis, Tennessee 38103

Attorneys for Appellee,
RILEY C. GARNER, Shelby County Trustee

WILLIAM C. BATEMAN, JR.
Assistant City Attorney
One Commerce Square
Suite 1100
Memphis, Tennessee 38103

Attorney for Appellee,
GLENN E. FOSTER, Treasurer of the City of Memphis

JOE C. PEEL
450 James Robertson Parkway
Nashville, Tennessee 37219

Attorney for Intervening Appellee,
WILLIAM M. LEECH, JR.,
Attorney General for the State of Tennessee

via U.S. mail, postage prepaid, this the 4th day of February, 1982.

/s/ DAVID C. SCRUGGS
David C. Scruggs

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK AND TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

Defendants.

Order On Judgment

This cause came on to be heard on December 19, 1980, before the Honorable D. J. Alissandratos, Chancellor of the Chancery Court of Shelby County, Tennessee, Part III; upon the second amended complaint filed by the plaintiff; upon the answer and counter complaint filed by the defendants; upon the answer of the counter defendant; upon the affidavits and the stipulation of facts filed by the parties; upon motions for summary judgment; upon the statements of counsel for the plaintiff and counsel for the defendants; and upon the entire record in the cause; and

IT APPEARS to the Court and the Court finds that the plaintiff's motion for summary judgment should be granted and that the defendants' motion for summary judgment should be denied, for the reasons set forth in the oral opinion of the Court which is incorporated by reference and made a part of the record herein, and that plaintiff should have and recover a judgment against the defendant in the amount hereafter set forth.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED:

1. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Riley C. Garner, Shelby County Trustee, in the amount of Fifteen Thousand Two

Hundred Nineteen and 13/100 ($15,219.13) Dollars plus legal interest thereon from January 11, 1979, to the date of entry of this judgment.

2. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Riley C. Garner, Shelby County Trustee, in the amount of Fourteen Thousand Two Hundred Sixty Three and 21/100 ($14,263.21) Dollars plus legal interest thereon from January 8, 1979, to the date of entry of this judgment.

3. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, in the amount of Fourteen Thousand Forty Eight and 43/100 ($14,048.43) Dollars plus legal interest thereon from January 4, 1979, to the date of entry of this judgment.

4. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, in the amount of Thirteen Thousand One Hundred Sixty Six and 04/100 ($13,166.04) Dollars plus legal interest thereon from January 4, 1979, to the date of entry of this judgment.

5. That this judgment be and the same is hereby stayed pending appeal.

6. That costs are assessed against the defendants.

/s/ D. J. ALISSANDRATOS
Chancellor

Date: 1/9/81

APPROVED:

/s/ J. MINOR TAIT, JR.,
J. Minor Tait, Jr., Assistant
County Attorney, Attorney for
Defendant, Riley C. Garner,
Shelby County Trustee

/s/ WILLIAM C. BATEMAN by J. M. T.
William C. Bateman, Attorney
for Defendant, Glenn E. Foster,
Treasurer of the City of Memphis,
Tennessee

/s/ JOE C. PEEL by Mary M. Weddington
Joe C. Peel, Assistant Attorney
General intervening on behalf
of Defendants

CERTIFICATE OF SERVICE

I, J. Minor Tait, Jr., certify that a copy of the foregoing order was hand delivered to attorney for plaintiff, Mr. David C. Scruggs, 900 Memphis Bank Building, Memphis, Tennessee 38103, this 9th day of January, 1981.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE
PART III

No. 85780-3

MEMPHIS BANK AND TRUST.

Plaintiff,

v.

SHELBY COUNTY, RILEY GARNER, *et al.*,

Defendants.

BE IT REMEMBERED, that the above-captioned cause came on to be heard at approximately 10:00 o'clock a.m., on the 19th day of December, 1980, in Part III of the above Court, before the HONORABLE D. J. ALISSANDRATOS, CHANCELLOR, presiding, when and where the following proceedings were had, to-wit:

APPEARANCES

For the Plaintiff:

DAVID C. SCRUGGS, ESQ.
Cobb, Edwards, Nichol, Woodall & Kelly
Suite 900
Memphis Bank Building
Memphis, Tennessee 38103

For the Defendant:

J. MINOR TAIT, JR., ESQ.
MISS MARY MARGARET WEDDINGTON
McDonald, Kuhn, Smith, Miller & Tait
2nd Floor, 150 East Court Ave.
Memphis, Tennessee 38103

For the State of Tennessee:

JOE C. PEEL, ESQ.
Assistant Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219

THE COURT: I wish to again thank y'all for a very thoughtfully and thoroughly prepared case, and also I appreciate the thoroughness of your oral argument.

The Court finds upon evaluation that the United States Constitution under the supremacy clause requires this Court to interpret 31 USCA 742 passed in 1976, and to interpret that that statute and the Tennessee Code Annotated 67-751 statute are in conflict, the Court specifically finding that the exceptions under the federal statute have not been met by the state statute. The state statute, therefore, must be declared unconstitutional under the Federal Constitution.

As to its application as to those stocks, bonds, treasury notes and other obligations of the United States as enumerated in the federal statute, the Court specifically finds that that does not invalidate the Tennessee statute for purposes of application for other intangible personal property, and, therefore, does not invalidate the statute completely.

The Court would point out that the statutes involved in this Court's opinion are clear and unambiguous. Therefore, the Court does not deem it appropriate to look at legislative intent. The Court deems it appropriate to look at legislative intent when the Court finds that the reading of a statute is unclear to the Court or is ambiguous or given its normal interpretation cannot be construed in a sensible manner by the Court. And, this Court has not had that difficulty in reviewing these statutes, and the purpose for that limitation in this Court's opinion is that the judiciary should not continuously be running to look at legislative intent on everything that the legislature does, except on those things where the Court has to, to try to figure out what do they mean.

This Court finds that the legislature passed a very clear statute and that it is in conflict with the federal statute, and, therefore, based on what the Court has already reiterated, the plaintiff's motion for summary judgment must be granted and costs be assessed against the defendant. Are there any questions?

MR. TAIT: Would Your Honor rule on our counterclaim for revival of the prior act?

THE COURT: I do not find that that would be appropriate based on what I indicated. I don't find that the statute is unconstitutional to the extent that it invalidates the entire statute, and, therefore, that relief would have to be denied. Are there any other questions?

MR. TAIT: If Your Honor please, one other question. Is Your Honor ruling that only, that the agencies of the United States are exempt or any instrumentalities of the United States?

MR. SCRUGGS: Your Honor, I would point out that you have referred purely to the exemption statute, and in our brief, as well as in the pleadings, we have picked up the various statutes also granting the same exemption by the agencies.

THE COURT: The Court's ruling only as to that one specific statute under the federal law. Any other questions?

MR. TAIT: Your Honor, I'm not clear. I just want to be sure I understand Your Honor's ruling. Is the Court ruling that the only exempt income is from stocks, bonds, treasury notes and other obligations of the United States as set forth in Section 742?

THE COURT: Yes, sir.

MR. TAIT: All right, sir.

MR. SCRUGGS: Well, now, Your Honor, you see in my complaint I have not only alleged the federal exemption statute but also the other federal statutes in regard to the federal land banks, the federal intermediate credit and the banks for cooperatives, which by federal statute are also exempt. Now, they have enabling federal statutes that also exempt them. I believe if you grant my summary judgment, you would be granting the exclusion of all these.

THE COURT: Well, gentlemen, the obligations as I see them, and those enumerated (a) through (e) on page 3 of the plaintiff's memorandum are the ones which I am granting relief on.

MR. SCRUGGS: All right, Your Honor.

THE COURT: And, those are — excuse me, they are not all specifically. I beg your pardon, they are not all specifically in USCA 742.

MR. SCRUGGS: Right, Your Honor. You see each of — (c), (d), and (e) are then covered by the other exemption statutes which I have cited to Your Honor.

MR. TAIT: Your Honor, one of our positions in this case was that if he was entitled to any exemption, it would only be as set forth in 31-742, which says obligations of the United States. Now, these matters that he has got in his brief are technically not obligations of the United States.

MR. SCRUGGS: Your Honor, if you will look at page 9 of my brief, you will see those other statutes, and in essence what those statutes say are that these agencies are in essence carrying out the duties and the obligations of the government, and, therefore, are extended the same exemption privilege as obligations of the United States, which I would say that they are obligations, and I think those statutes are just as clear and precise.

MR. PEEL: Your Honor, I think there is a factual problem too on the other instrumentalities question that the plaintiff doesn't have in the record.

THE COURT: I thought y'all had a stipulation of fact.

MR. SCRUGGS: We do, Your Honor.

MR. PEEL: This is a subject of which I'm not quite clear the status of it, but there was something to be worked out last week. This is a tangential issue.

MR. SCRUGGS: Your Honor —

THE COURT: (Interposing) One at a time. Let him get it all out.

MR. PEEL: The point that I understood previously was that in order for these things to even be deemed an instrumentality of the United States, the shares had to be owned by the government or the farm credit service; is that correct?

MS. WEDDINGTON: One of them.

MR. PEEL: One of these instrumentalities, so we haven't really discussed this point this morning thoroughly enough to give Your Honor a basis on which to rule on it. It seems to me there is a factual

problem that the plaintiff has not established that the shares of — which one is it — are actually owned by the governor of the farm credit service.

MR. SCRUGGS: Your Honor, if I might address the Court on this point, we have stipulated, the parties have stipulated that these are the various types of securities that are the subject of this lawsuit.

Your Honor, I have pled in my complaint, and we have also briefed the issue, as well as the defendants have briefed the response, that these obligations of these certain instrumentalities of the United States should or should not be granted the exemption, but it is clearly an issue before you, and those statutes recognize that these instrumentalities are granted the same exemptions as other obligations of the United States.

MR PEEL: In 12 USC, Section 1234 —

THE COURT: (Interposing) 2134.

MR PEEL: 2134, I'm sorry, says the exemption provided in the preceding sentence shall apply only for the year or any part thereof in which the stock in the bank or cooperative is held by the governor of the farm credit service, so that fact is something established in the record. I think before the Court really makes an accurate ruling on that point, that would have to be in the record.

THE COURT: What about with regard to 12 USC 2079?

MS. WEDDINGTON: Your Honor, may I respond to the question of the farm credit system banks?

THE COURT: Before you do, let him respond. There are two other sections.

MS. WEDDINGTON: 2079 and 2055.

THE COURT: Go ahead.

MS. WEDDINGTON: If I may interject myself at this point, and I would first ask a question of the Court. Is Your Honor saying that the 1959 amendment is what has brought about the result of your holding under 742?

THE COURT: Before I respond to that —

MS. WEDDINGTON: (Interposing) Because that is not in —

THE COURT: (Interposing) Y'all have told the Court that y'all have a stipulation of fact. Now, I find after I rendered a ruling, suddenly the stipulation of fact starts disintegrating, so I just want to find out where we stand.

MS. WEDDINGTON: Yes, there is a stipulation of fact. However, in that stipulation the plaintiff would have the burden of putting into the record any fact upon which it wishes to rely. If Your honor is saying that the 1959 amendment has changed the law, and, therefore, 742 precludes the Tennessee statute, Your Honor will also note the language of the 1959 amendment is not included in these exemption statutes for the federal farm credit system banks.

Therefore, since that language is not here, and since these statutes were enacted after the 1959 amendment in 1971, the implication would be that Congress intended to preserve the exemption for bank shares.

THE COURT: Now, the three statutes that y'all have referred to here, 2134, 2079 and 2055, according to what's been submitted to the Court, those have been amended as of 1980; is that not correct?

MS. WEDDINGTON: If Your Honor please, there was a reference to Supp. 1980, which that is something the codification in the big book had not been put together. The language is the same.

If Your Honor will let me, I will go to the library and bring the Code out. It has now been bound in the full volume, and it is a 1980 volume of the 1971 Act.

THE COURT: Well, I still don't see what that has to do with anything, but thank you for telling me about that. Anything else?

MR. SCRUGGS: Yes, Your Honor. This point has been addressed thoroughly in the briefs. If you will remember, Your Honor, in the responsive pleading filed by the defendants, they brought up the issues of the farm, the federal farm credit system, and in my brief, which was filed yesterday, the second issue is Congress properly exercised its authority in the United States Constitution in estab-

lishing federal land banks, banks for cooperatives, and federal intermediate credit banks in exempting the obligations of these banks from state taxation, and then, Your Honor, we cited to you the Smith case and all the history that gives Congress the power to exempt the obligations of these agencies and instrumentalities, but, Your Honor, the point is that the federal exemption statute would cover the treasury obligations and the treasury notes and the T-bills.

Then the exemption statutes contained for each of these agencies clearly states that the income therefrom shall be exempt from all federal, state, municipal and local taxation, just as clear and succinct as the other statute, but those statutes, all four statutes are relied on by the defendant — I mean the plaintiff because of their applicability to the various types of obligations.

THE COURT: The Court adopts as part of its opinion in this matter that the Sections 2134, 2079 and 2055, which again they very clearly say, you know, shall be exempt from all federal, state, municipal and local taxation other than federal income tax liability.

I agree that those under the supremacy clause take precedent over the state statute. It's a burden on the plaintiff, whenever the tax man comes around, to show that these fall underneath here.

The Court finds that the record is still complete based on the stipulation of fact that's written into the record that the Court finds that there is no necessity for any proof since there is no material proof in dispute, the only dispute being that if they claim a certain issue not to be, excuse me, to be under the federal, one of the federal statutes, that is a fact dispute that's not relevant to the ruling by this Court, and that is that if it is and does fall under one of these four federal statutes, that it would be exempt under the tax by the state that is part, the taxation statute of 67-751.

Now, are there any questions remaining?

MR. TAIT: I have nothing else.

THE COURT: Thank you very much, gentlemen and ma'am.

* * * * *

CERTIFICATE

STATE OF TENNESSEE
COUNTY OF SHELBY

I, BRENDA F. RICHBERGER, CSR, RPR, a Notary Public in and for the said State and County, do hereby certify that the foregoing is a transcript of the proceedings in the above-styled cause in the Chancery Court of Shelby County, Tennessee, and that I did report in Stenograph and take down verbatim the proceedings in said cause, and the foregoing pages, 1 through 14, inclusive, constitute a true and correct transcript of the proceedings of said cause.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal this 22nd day of December, 1980.

/s/ BRENDA F. RICHBERGER, CSR, RPR
Notary Public at Large

My Commission Expires:
December 27, 1981.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK AND TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

Stipulation

TO THE HONORABLE D. J. ALISSANDRATOS, CHANCELLOR,
PART III, OF THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE:

The parties hereto stipulate the following facts:

1. On January 4, 1979, Plaintiff paid under protest to Defendant Glenn E. Foster, Treasurer of the City of Memphis, the sums of Fourteen Thousand, Forty-Eight and 43/100 Dollars ($14,048.43) representing intangible personal property taxes for the year 1977 and Thirteen Thousand, One Hundred Sixty-Six and 04/100 Dollars ($13,166.04) representing intangible personal property taxes for the year 1978.

2. Plaintiff paid under protest to Defendant Riley C. Garner as Shelby County Trustee on January 11, 1979 the sum of Fifteen Thousand, Two Hundred Nineteen and 13/100 Dollars ($15,219.13) representing the intangible personal property taxes for the year 1977 and on January 8, 1979, the sum of Fourteen Thousand, Two Hundred Sixty-Three and 21/100 Dollars ($14,263.21) representing intangible personal property taxes for the year 1978.

3. In 1976, the base year for the 1977 intangible personal property tax, Memphis Bank & Trust Company had "net earnings"

for purposes of the intangible personal property tax of One Million, Three Hundred Eighty-Nine Thousand, Five Hundred Twenty-Two Dollars ($1,389,522). Included in that amount was "interest on obligations of the United States and U.S. instrumentalities" as reported on line 5 of its 1976 U.S. Corporation Income Tax Return in the amount of Three Million, One Hundred Seventy-Six Thousand, One Hundred Sixteen Dollars ($3,176,116) composed of the following:

(a) $928,219 from U.S. Treasury Notes,

(b) $216,984 from U.S. Treasury Bills,

(c) $2,030,913 from various United States agencies as follows:

Federal Land Bank	$1,247,095
Federal Intermediate Credit Bank	$ 546,904
Farmers Home Administration	$ 88,576
Federal National Mortgage Association	$ 148,338

4. In 1977, the base year for the 1978 intangible personal property tax, Plaintiff's "net earnings" for purposes of the intangible personal property tax was One Million, Five Hundred Five Thousand, Four Hundred Twenty-Four Dollars ($1,505,424). Included in that amount was "interest on obligations of the United States and U.S. instrumentalities" as reported on line 5 of its 1977 U.S. Corporation Income Tax Return of Three Million, Five Hundred Seventy-Five Thousand, Six Hundred Sixty-Seven Dollars ($3,575,667) composed of the following:

(a) $804,262 from U.S. Treasury Notes,

(b) $44,536 from U.S. Treasury Bills,

(c) $2,726,869 from various United States agencies as follows:

Federal Land Bank	$1,625,602
Federal Intermediate Credit Bank	$ 656,551
Banks for Cooperatives	$ 265,000
Farmers Home Administration	$ 88,365
Federal National Mortgage Association	$ 91,351

5. Plaintiff, Memphis Bank & Trust Company, paid intangible personal property taxes in the amount of Twenty-Nine Thousand, Two Hundred Sixty-Seven and 56/100 Dollars ($29,267.56) for the year 1977. The tax liability was computed as follows:

Net Earnings	$1,389,522.00
Times 3%	x .03
Gross Intangible Personal Property Tax	41,685.66
Less:	
Credit of 10% of Ad Valorem Taxes Paid by Memphis Bank & Trust	(12,418.10)
Total 1977 Intangible Personal Property Taxes Payable	$ 29,267.56

Memphis Bank & Trust Company paid the total 1977 tax liability in the amounts of Fourteen Thousand, Forty-Eight and 43/100 Dollars ($14,048.43) to the Defendant Treasurer of the City of Memphis and Fifteen Thousand, Two Hundred Nineteen and 13/100 Dollars ($15,219.13) to the Defendant Shelby County Trustee.

6. Memphis Bank & Trust Company paid intangible personal property taxes in the amount of Twenty-Seven Thousand, Four Hun-

dred Twenty-Nine and 25/100 Dollars ($27,429.25) for the year 1978. The tax liability was computed as follows:

Net Earnings	$1,505,425.00
Times 3%	x .03
Gross Intangible Personal Property Tax	45,162.75
Less:	
Credit of 10% of Ad Valorem Taxes Paid by Memphis Bank & Trust Company	(17,733.50)
Total 1978 Intangible Personal Property Taxes Payable	$ 27,429.25

Memphis Bank & Trust Company paid the total 1978 tax liability in the amounts of Thirteen Thousand, One Hundred Sixty-Six and 04/100 Dollars ($13,166.04) to the Treasurer of the City of Memphis and Fourteen Thousand, Two Hundred Sixty-Three and 21/100 Dollars ($14,263.21) to the Shelby County Trustee.

7. Plaintiff's "net earnings" for the year 1976 the base of the 1977 intangible personal property tax, amounted to One Million, Three Hundred Eighty-Nine Thousand, Five Hundred Twenty-Two Dollars ($1,389,522). If the following amounts of interest from the named sources is excluded from "net earnings", Memphis Bank & Trust Company's "net earnings" is less than $0; therefore, there would be no 1977 intangible personal property tax liability.

United States Treasury Notes	$928,219
United States Treasury Bills	$216,984
Federal Land Bank	$1,247,095
Federal Intermediate Credit Bank	$546,904
TOTAL	$2,939,202

8. Plaintiff's "net earnings" for the year 1977, the base of the 1978 intangible personal property tax, amounted to One Million, Five Hundred Five Thousand, Four Hundred Twenty-Four Dollars ($1,505,424). If the following amounts of interest from the named sources is excluded from "net earnings", Memphis Bank & Trust Company's "net earnings" is less than $0; therefore, there would be no 1978 intangible personal property tax liability.

United States Treasury Notes	$804,262
United States Treasury Bills	$44,536
Federal Land Bank	$1,625,602
Federal Intermediate Credit Bank	$656,551
Banks for Cooperatives	$265,000
TOTAL	$3,395,951

9. Debentures of the Federal National Mortgage Association and Farmers Home Administration are not treated as United States obligations. Interest received by Plaintiff from such obligations is properly includable in "net earnings", the base of the intangible personal property tax, without violating the Federal Exemption Statute of 31 U.S.C. § 742 or other federal statutes.

10. The Tennessee Franchise and Excise Tax returns for the years 1976 and 1977 for Memphis Bank & Trust Company are hereby stipulated into evidence as collective exhibit 1 with authority to substitute copies of the original tax returns which are in the possession of the Internal Revenue Service and Tennessee Department of Revenue, respectively.

This Stipulation agreed to between the parties this 23 day of October, 1980.

COBB, EDWARDS, NICHOL, WOODALL & KELLY

/s/ DAVID C. SCRUGGS
David C. Scruggs
Attorney for Plaintiff

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.
Attorney for Defendant,
Riley C. Garner,
Shelby County Trustee

/s/ WILLIAM C. BATEMAN by J. M. T.
William C. Bateman
Attorney for Defendant,
Glenn E. Foster, Treasurer
of the City of Memphis

/s/ JOE C. PEEL by Mary M. Weddington
Joe C. Peel
Assistant Attorney General,
Intervening on Behalf
of Defendant

*The stipulation included as exhibits the Franchise and Excise Tax Returns filed by Appellant with the Tennessee Department of Revenue. Since this information was stipulated, these forms are not included in this Appendix.

Federal Agency Exemption Statutes

12 U.S.C. § 2055. Taxation

Every Federal land bank and every Federal land bank association and the capital, reserves, and surplus thereof, and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by a Federal land bank or a Federal land bank association to the same extent, according to its value, as other similar property held by other persons is taxed. The mortgages held by the Federal land banks and the notes, bonds, debentures and other obligations issued by the banks or associations shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 742(a)).

12 U.S.C. § 2079. Taxation

Every Federal intermediate credit bank and the capital, reserves, and surplus thereof and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation except taxes on real estate held by a Federal intermediate credit bank to the same extent, according to its value, as other similar property held by other persons is taxed. The obligations held by the Federal intermediate credit banks and the notes, bonds, debentures, and other obligations issued by the banks shall be deemed to be instrumentalities of the Government of the United States, and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 742(a)).

12 U.S.C. § 2134. Taxation

Each bank for cooperatives and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such bank shall be exempt, both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority. Such banks, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed

by the United States or by any State, territorial, or local taxing authority; except that interest on the obligations of such banks shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941 (31 U.S.C. 742(a)) and except that any real and tangible personal property of such banks shall be subject to Federal, State, territorial, and local taxation to the same extent as similar property is taxed. The exemption provided in the preceding sentence shall apply only for any year or part thereof in which stock in the bank for cooperatives is held by the Governor of the Farm Credit Administration.

1977 Public Acts Of The State Of Tennessee, Chapter 140, Section 1(A) & (B)

WHEREAS, The people of Tennessee amended Article 2, Section 28 of the Constitution of Tennessee in August 1972; and

WHEREAS, The State Constitution, as amended, delegates certain powers to the Legislature relative to the assessment and taxation of intangible personal property and the assessment and taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions; and

WHEREAS, The State Constitution, as amended, empowers the Legislature to classify intangible personal property into subclassifications and to establish a ratio of assessment to value in each subclass; and

WHEREAS, The State Constitution further empowers the Legislature to direct the manner in which banks, insurance companies, loan and investment companies, savings and loan associations and similar financial institutions shall be assessed and taxed; and

WHEREAS, The State Constitution further empowers the Legislature to direct the manner in which the value and definitions of property in each class or subclass shall be ascertained; and

WHEREAS, The State Board of Equalization has conducted certain studies and made certain reports and recommendations to the General Assembly pursuant to Chapter 226 of the Public Acts of 1973; and

WHEREAS, The reports prepared by the State Board of Equalization show that there is great disparity and lack of uniformity in the manner in which intangible personal property assessments have been administered across the state; and

WHEREAS, House Joint Resolution 428 adopted by the Eighty-Ninth General Assembly authorized the appointment of a special joint committee to study the laws relating to taxation of intangible personal property and the laws relating to taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions and to report to the Ninetieth General Assembly and the said committee has conducted a thorough study of these matters, has held public hearings and has made its report and recommendations to the

Ninetieth General Assembly which report concluded that banks and banking associations require careful regulation and supervision by state and federal authorities to protect the interest of their depositors and assure their financial soundness and such regulatory authorities frequently request and often require that banks increase their capitalization; that the current manner of taxing bank shares discourages a strong capital structure contrary to the arms of the regulatory authorities and often penalizes new banks which are required to maintain higher capital ratios; that a manner of taxing the intangible value of bank shares based upon the net earnings of the bank would be more equitable and appropriate, but that any revision in the manner of taxing bank shares should contain provisions to assure the protection of the revenues currently received by county and municipal governments; and

WHEREAS, The Legislature affirms and supports the conclusions of the special committee which deal primarily with the taxation of bank shares and specifically reserves to itself the right to create further subclasses of intangible personal property and to determine the manner of taxation; now, therefore:

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 67, Chapter 7 is amended by adding the following new sections:

(A) Banks. There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by Tennessee Code Annotated, Title 67, Chapter 27. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever named called, including other intangible corporate property of

such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under Tennessee Code Annotated, Title 67, Chapter 27 and all other taxes to which it is currently subject.

(B) Minimum Tax. In no event shall the tax imposed under subsection (A) upon any bank be less than an ad valorem tax calculated on the basis of sixty percent (60%) of the book value of the bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits.

In determining the value to be assessed, the following shall be deducted from the sixty percent (60%) book value:

(1) The appraised value of all real property and tangible personal property otherwise owned and assessed to companies subject to this tax; and

(2) The appraised value of all real property in Tennessee occupied by companies subject to this tax and used for the purpose of conducting their business under a lease which provides that all ad valorem taxes on such property shall be paid by such companies and said lease has been registered in the county where such property is located.

The remaining value shall be assessed by forty percent (40%) and the resulting assessment shall be the amount to which the appropriate city and county tax rates shall be applied to determine the tax due and payable to the respective taxing jurisdictions.

Title 67, Tennessee Code Annotated

CHAPTER 29
CORPORATE FRANCHISE TAX

67-2901. Short title. — This chapter may be cited and referred to as "The Franchise Tax Law."

67-2902. Corporations subject to tax. — (a) All corporations, cooperatives, joint-stock associations, and business trusts, including regulated investment companies and real estate investment trusts; organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue, annually a privilege tax in addition to all other taxes, the rate and measure of which are hereinafter set forth. The tax shall be paid for the privilege of engaging in business in corporate form in this state and shall be in addition to all other taxes levied by any other statute.

(b) Every such taxable entity organized and existing under and by virtue of the laws of this or any other state, territory or country, or organized and existing without any specific statutory authority, now or hereafter doing business within this state, without domesticating or qualifying to do business in this state, or while its charter is forfeited, revoked or suspended, shall as a recompense for the protection of its local activities and as compensation for the benefits it receives from doing business in Tennessee, pay the tax imposed by this chapter.

(c) The tax imposed by this chapter shall apply to corporations whose business is being conducted by a receivership or trusteeship appointed by any court of competent jurisdiction and shall continue to accrue until such time as the corporation has been actually and legally dissolved or withdrawn from this state.

(d) There shall be exempt from the payment of the tax levied under this chapter any corporation organized under the laws of the state of Tennessee whose sole expressed corporate purpose is for the furthering of industrial development in communities throughout the state, and doing related matters thereto, and whose stockholders receive no income other than interest or dividends on money invested in said corporation for constructing industrial buildings and whose officers receive no compensation.

67-2903. Rate of tax. — The privilege tax hereby imposed shall be a tax of fifteen cents (15¢) on the one hundred dollars ($100), or major fraction thereof, of the issued and outstanding stock, surplus and undivided profits of each such corporation as shown by the books and records of such corporation at the close of its last fiscal year preceding the making of the sworn report hereinafter required. For purposes of this section "issued and outstanding" stock shall not include treasury stock.

* * *

Title 67, Tennessee Code Annotated

CHAPTER 27
EXCISE TAX ON CORPORATE EARNINGS

67-2701. Short title. — This chapter may be cited and referred to as "The Excise Tax Law."

67-2702. Corporations subject to tax — Rate. — (a) All corporations, cooperatives, joint-stock associations, and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue, annually an excise tax, in addition to all other taxes, equal to six per cent (6%) of the net earnings for the next preceding fiscal year for business done in this state.

(b) Every such taxable entity organized and existing under and by virtue of the laws of this or any other state, territory or country, or organized and existing without any specific statutory authority, now or hereafter doing business within this state, without domesticating or qualifying to do business in this state, or while its charter is forfeited, revoked or suspended, shall as a recompense for the protection of its local activities and as compensation for the benefits it receives from doing business in Tennessee, pay the tax imposed by this chapter.

(c) The tax imposed by this chapter shall apply to corporations whose business is being conducted by a receivership or trusteeship appointed by any court of competent jurisdiction and shall continue to accrue until such time as the corporation has been actually and legally dissolved or withdrawn from this state.

(d) There shall be exempt from the payment of the tax levied under this chapter the following:

(1) Any corporation organized under the laws of the state of Tennessee whose sole expressed corporate purpose is for the furthering of industrial development in communities throughout the state, and doing related matters thereto, and whose stockholders receive no income other than interest or dividends on money invested in said corporation for constructing industrial buildings and whose officers receive no compensation.

(2) Corporations organized for the purpose of erecting, owning or operating a common meeting place for more than one (1) Masonic Lodge, more than one (1) Lodge of Odd Fellows, or similar lodges, and which corporations could obtain general welfare charters, and in which corporations all the stock is owned by lodges participating in the common temple or meeting place, regardless of the type of charter held by said operating corporations, except on income received by said corporation as rentals for use for commercial purposes.

* * *

67-2704. "Net earnings" defined. — The term "net earnings" is defined as federal taxable income before the operating loss deduction and special deductions provided for in §§ 241 through 247 and 249 through 250 of the Internal Revenue Code as required to be reported by corporations under the Internal Revenue Code, subject to the following adjustments:

(a) There shall be added to the federal taxable income:

(1) Excise tax imposed by this state to the extent deducted in determining federal taxable income.

(2) Interest income earned on bonds and other obligations of other states or their political subdivisions less allowable amortization.

(3) Any deduction made pursuant to §§ 611-617 of the Internal Revenue Code to the extent the deduction when added with similar deductions in prior years exceeds the cost of the property.

(4) Gains not recognized pursuant to § 337 of the Internal Revenue Code.

(5) The charitable contributions deduction claimed under § 170 of the Internal Revenue Code.

(6) Any capital loss carrybacks or carryovers deducted pursuant to § 1212 (a) of the Internal Revenue Code.

(b) There shall be subtracted from the federal taxable income:

(1) Dividends earned by a parent corporation from a subsidiary corporation where such parent owns eighty percent (80%) or more of the stock of the subsidiary.

(2) Any amount included in federal taxable income but not taxable under the law of this state.

(3) Any net operating loss incurred, which is defined as the excess of allowable deductions over total income allocable to this state for the year of the loss, and which may be carried over and allowed in succeeding tax years until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than three (3) years after the taxable year in which the net operating loss occurs.

(4) A portion of the gain or loss on the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis.

(5) Actual charitable contributions made by the corporation during the fiscal year.

(6) Losses not deducted pursuant to § 337 of the Internal Revenue Code.

(7) Any capital losses incurred during the fiscal year and not deductible under § 1211 (a) of the Internal Revenue Code.

(8) Any expense, other than income taxes, not deducted in determining federal taxable income for which a credit against the federal income tax is allowable. This subdivision shall apply to taxable periods ending on and after December 31, 1977.

Joint Appendix

Office - Supreme Court, U.S.
FILED
JUL 30 1982
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CLERK

No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

MEMPHIS BANK & TRUST COMPANY, *Appellant*,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE, *Appellees*.

Appeal From The Supreme Court Of Tennessee

JOINT APPENDIX

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Appeal Docketed March 1, 1982.
Probable Jurisdiction Noted April 26, 1982.

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IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE

Intervening Defendant.

DOCKET ENTRIES

DOCUMENT	DATE FILED
Complaint for recovery of taxes paid under protest	June 27, 1979
Stipulation Extending Time to Answer	July 12, 1979
Stipulation Extending Time	July 17, 1979
Consent order allowing the Defendant, Riley C. Garner, Shelby County Trustee, additional time to move on plead	August 24, 1979
Answer of Defendant, Glenn E. Foster	August 28, 1979
Answer of Defendant, Riley C. Garner	September 26, 1979

Plaintiff's Motion for Summary Judgment WITH Affidavit (Morlino, Dated May 9, 1980) with Exhibits A & B	May 9, 1980
Consent Order allowing amendment of original Complaint	
Amended Complaint	June 5, 1980
Affidavit (Scruggs, dated June 3, 1980)	June 5, 1980
Answer of Defendant, Riley C. Garner to first Amended Complaint	June 24, 1980
Response of Defendant, Riley C. Garner to Motion for Summary Judgment	June 24, 1980
Motion	June 27, 1980
Answer of Defendant, Glenn E. Foster to first Amended Complaint	July 1, 1980
Response of Defendant, Glenn E. Foster to Plaintiff's Motion for Summary	July 1, 1980
Motion for Leave to Intervene	August 7, 1980
Motion	August 8, 1980
Answer of Intervening Defendant, Leech	August 8, 1980
Affidavit (Morlino, dated August 7, 1980)	August 8, 1980

Order allowing intervention	August 11, 1980
Consent Order allowing second amended Complaint	September 12, 1980
Second Amended Complaint	September 12, 1980
Defendant's Answer to second amended Complaint	October 14, 1980
Defendant's Motion for leave to amend Answer to set up Counter-Claim	October 17, 1980
Affidavit (Wray, dated October 8, 1980) and Exhibits A through D	October 24, 1980
Stipulation of fact	October 24, 1980
Order on Defendant's Motion to set up Counter-Claim	October 31, 1980
Affidavit (Morlino, dated September 9, 1980)	October 31, 1980
Motion	October 31, 1980
Defendant's Amended Answer and Counter-Claim	November 3, 1980
Plaintiff's reply to Defendant's Counter-Claim	November 26, 1980
Motion	December 5, 1980
Motion	December 19, 1980
Defendant's Motion for Summary Judgment	December 12, 1980
Affidavit (Murray, dated December 12, 1980) with Exhibits I and II	December 17, 1980
Transcript of Chancellor's Oral Opinion	January 9, 1981

Order on Judgment	January 9, 1981
Notice of Appeal	January 28, 1981
Designation of Record	February 10, 1981
Order from Supreme Court for Stay of Issuance of Mandate	December 31, 1981

This is to certify that the foregoing is a true and correct copy of the docket entries in Chancery Court in cause number 85780-3.

/s/ JOYCE AVERY
Joyce Avery, Deputy Clerk and Master

IN THE SUPREME COURT OF TENNESSEE
WESTERN SECTION AT JACKSON

Shelby Equity #6

MEMPHIS BANK & TRUST CO.

Appellee

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE
and GLENN E. FOSTER, TREASURER OF THE
CITY OF MEMPHIS, TENNESSEE
and WILLIAM M. LEECH, JR.

Appellants

DOCUMENTS FILED IN THE SUPREME COURT

Transcript (3 volumes) filed	3-26-81
Motion for extension of time to file Appellant's Brief filed by J. Minor Tait, Jr., Mary Margaret Weddington, William Bateman, Jr. & Joe C. Peel	4-20-81
Order extending time to May 26, 1981, to file Appellant's Brief by William H. D. Fones, J.	4-24-81
Appellant's Brief filed by J. Minor Tait, Jr. & Mary Margaret Weddington	5-26-81
Motion for extension of time to file Appellant's Brief by Joe C. Peel	5-26-81
Order extending time to June 2, 1981, to file State's Brief by William H. D. Fones, J.	5-28-81
Additional Citations & Letter filed by J. Minor Tait, Jr.	6-1-81
Brief of Attorney General filed by Joe C. Peel	6-2-81

Motion for order extension to file Brief of Appellee filed by David C. Scruggs	6-26-81
Order extending time to July 13, 1981, to file Appellee's Brief by William H. D. Fones, J.	6-26-81
Brief of Memphis Bank & Trust filed by David C. Scruggs & Andrew Raines	7-13-81
Motion of Attorney General for extension to file Brief filed by Joe C. Peel	7-27-81
Order extending time to August 11, 1981, to file State's Brief by William H. D. Fones, J.	7-24-81
Motion to file Reply of Appellants, Riley C. Garner, *et al* filed by J. Minor Tait, Jr., Mary Margaret Weddington, and William Bateman, Jr.	7-27-81
Order extending time to August 4, 1981, to file Appellants' Reply by William J. Harbison, C.J.	7-27-81
Reply Brief of Appellants filed by J. Minor Tait, Jr., Mary Margaret Weddington, and William Batement, Jr.	8-4-81
Reply Brief of Attorney General filed by Joe C. Peel	8-11-81
Letter of Citations Pursuant to Rule 27(d) filed by David C. Scruggs	10-7-81
Opinion of the Supreme Court by William J. Harbison, C.J. (Reversed & Dismissed, Remanded for Costs)	11-30-81
Motion for Stay of Issuance of Mandate Pending Filing of Appeal to the USSC by David Scruggs & Andrew Raines	12-10-81
Consent Order for Stay of Issuance of Mandate Staying Judgment Pending the Filing of a Petition to the USSC & Final Determination of that Appeal approved by William J. Harbison, C.J.	12-28-81

Notice of Appeal to the USSC
filed by David Scruggs 2-5-82

THE STATE OF TENNESSEE

I, JEWEL REDDEN, Clerk of the Supreme Court of said State for the Western Division thereof, at Jackson, do hereby certify that the foregoing is a true, perfect and complete copy of the DOCUMENTS FILED IN THE SUPREME COURT pronounced by said Court at its April Term, 1982, in the case of MEMPHIS BANK & TRUST CO. against RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE, and WILLIAM M. LEECH, JR. as appears of record now on file in my office.

In testimony whereof, I have hereunto set my hand and affixed the seal of the Court, at office, in the City of Jackson, on this, the 4th day of May A.D., 1982

/s/ JEWEL REDDEN Clerk
By _____

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

COMPLAINT FOR RECOVERY OF TAXES PAID UNDER PROTEST

TO THE HONORABLE CHANCELLORS OF THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE:

The Plaintiff, Memphis Bank & Trust Company, respectfully shows unto the Court as follows:

I.

Memphis Bank & Trust is a state banking association organized under the law of the State of Tennessee with its principal office in Memphis, Shelby County, Tennessee.

II.

The Defendants, Riley C. Garner and Glenn E. Foster are both citizens of Memphis, Shelby County, Tennessee and are the officers charged by state and local law to collect pursuant to Tenn. Code Ann. § 67-759 (Supp. 1978) the Intangible Personal Property Tax imposed by Tenn. Code Ann. §§ 67-751 through 763 (Supp. 1978) for the

County of Shelby, Tennessee, and the City of Memphis, respectively.

III.

This is an action for the recovery of the Intangible Personal Property Tax erroneously, illegally and improperly assessed and collected from the Plaintiff pursuant to Tenn. Code Ann. § 67-751, et seq.

The action is filed by Plaintiff pursuant to Tenn. Code Ann. § 67-2305, 2306 (1976). These statutes provide that the person or party making payments of taxes under protest has the right to sue the officer having collected the said sums for recovery thereof, with interest not exceeding the legal rate, at any time within six months after making said payment. Plaintiff is filing within that time period.

IV.

On January 4, 1979, Plaintiff paid under protest to Defendant, Glenn E. Foster as Treasurer of the City of Memphis, the sums of $14,048.43 representing the Intangible Personal Property Tax for the year 1977 and $13,166.04 representing the Intangible Personal Property Tax for 1978.

V.

On January 11, 1979, Plaintiff paid under protest to Defendant, Riley C. Garner as Shelby County Trustee, the sum of $15,219.13 representing the Intangible Personal Property Tax for the year 1977 and on January 8, 1979, the sum of $14,263.21 representing the Intangible Personal Property Tax for the year 1978.

VI.

Tenn. Code Ann. § 67-751 (Supp. 1978) provides a subclassification of intangible personal property designated as "shares of banks and banking associations." The statute further provides:

> . . . All property in this subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing

business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes or the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject. [Acts 1977, ch. 140, § 1.]

VII.

For the tax year 1978, Tenn. Code Ann. § 67-2704 (1976), referred to in the above statute, provides that the term "net earnings" is defined as Federal taxable income, with a list of various adjustments to be made. The above cited section is applicable to the computation of the "net earnings" for the year 1977, which is the basis for the imposition of the tax for the calendar year 1978. This statute, however, leaves in the computation of "net earnings" interest on obligations of the United States and its political subdivisions.

Prior to the enactment of Tenn. Code Ann. § 67-2704 (1976) "net earnings" was determined pursuant to Tenn. Code Ann. § 67-2701 (Supp. 1975). This statute did not define net earnings but provided that certain adjustments would be made thereto. In any event, net earnings under this previous statute also included interest on obligations of the United States.

VIII.

The basis of this action is that the portion of the taxes imposed by the Defendants pursuant to Tenn. Code Ann. § 67-751 attributable to interest on United States obligations violates 31 U.S.C. § 742 which provides:

Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be

> exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

In addition, U.S. CONST. art. VI provides:

> This Constitution and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or the laws of any state to the contrary notwithstanding.

IX.

The Defendants have assessed and collected taxes based on the "net earnings" of the Plaintiff. Tax exempt interest from Federal obligations constituted a portion of the "net earnings" so taxed.

In 1976, the base year for the 1977 Intangible Personal Property Tax, Memphis Bank & Trust Company had total taxable income for purposes of computation of this tax of $1,389,522; however, included in that amount was interest on obligations of the United States in the amount of $2,959,132. In 1977, the base year for the 1978 Intangible Personal Property Tax, Memphis Bank & Trust Company's taxable income was $1,505,424; however, included in that amount was interest on obligations of the United States in the amount of $3,531,131. If these amounts had been excluded pursuant to 31 U.S.C. § 742, there would have been no net earnings of the Plaintiff and, therefore, no Intangible Personal Property Tax.

Therefore, by assessing and collecting taxes based on taxable income which includes exempted United States interest, the Defendants have erroneously, illegally and improperly carried out their duties and Plaintiff has been wrongfully assessed, the taxes unlawfully required to be paid, and Plaintiff is entitled to recover them in this action. Such assessment and collection violates the Federal exemption statute, 31 U.S.C. § 742 and is unconstitutional under the Supremacy Clause of the United States Constitution, U.S. CONST., art. VI.

WHEREFORE, PREMISES CONSIDERED, PLAINTIFF PRAYS:

1. That process issue and be served upon the Defendants in this matter and that each be required to answer within the time provided for by law;

2. That the Plaintiff, Memphis Bank & Trust Company, be granted a judgment against the Defendant, Glenn E. Foster, as Treasurer of the City of Memphis and against the City of Memphis in the amount of $27,214.47 with all interest provided for by law from the date of payment under protest of the taxes to date of judgment;

3. That the Plaintiff, Memphis Bank & Trust Company be granted a judgment against Defendant, Riley C. Garner, as Trustee of Shelby County and against the County of Shelby in the amount of $29,482.34 with all interest provided for by law from the date of payment under protest of the taxes to date of judgment, and

4. That Plaintiff, Memphis Bank & Trust Company have such other and further relief to which it may be entitled in the premises.

/s/ DAVID C. SCRUGGS
David C. Scruggs
Attorney for Plaintiff
Cobb, Edwards, Hamlet, Nichol & Woodall
900 Memphis Bank Building
Memphis, Tennessee 38103
901/525-6781

Certificate Of Service

I, David C. Scruggs, hereby certify that a copy of the foregoing Complaint has been served upon the Honorable William Leech, Jr., Attorney General of the State of Tennessee, pursuant to Rule 24.04 of the Tennessee Rules of Civil Procedure, by mailing a copy of same to his office at 450 James Robertson Parkway, Nashville, Tennessee 37219, first class, postage prepaid, this 27th day of June, 1979.

/s/ DAVID C. SCRUGGS

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, *et al.*,

Defendants.

ANSWER OF DEFENDANT GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE

Defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee for answer to the Complaint heretofore filed against him says:

First Defense. Plaintiff fails to state a claim upon which relief can be granted.

Second Defense. Answering the allegations in the order presented, defendant says:

I.

This defendant neither admits nor denies the allegations contained in paragraph I and demands strict proof in regard thereto.

II.

This defendant admits the allegations contained in paragraph II.

III.

This defendant denies that the tax in question was erroneously, illegally and improperly assessed and collected and admits the other allegations in paragraph III.

IV.

This defendant admits the allegations in paragraph IV.

V.

This defendant neither admits nor denies the allegations contained in paragraph V and demands strict proof in regard thereto.

VI.

This defendant admits the allegations in paragraph VI.

VII.

This defendant denies the allegations in paragraph VII.

VIII.

This defendant admits that the cited provisions from the United States constitution and the United States statutes are accurately cited, but denies that said provisions have been violated by the defendants.

IX.

This defendant denies the allegations contained in paragraph IX.

All allegations not heretofore admitted nor denied are herein now denied.

This defendant having fully answered this Complaint heretofore filed against him prays that he be now dismissed and allowed to go hence at the cost of the plaintiff.

STAFF ATTORNEY FOR DEFENDANT GLENN E. FOSTER, TREASURER.

CERTIFICATE OF SERVICE

The undersigned staff attorney for defendant hereby certifies that a copy of the foregoing Answer was mailed this ____ day of _____ , 1979, to David C. Scruggs, Attorney for Plaintiff, 900 Memphis Bank Bldg., Memphis, TN 38103 and to Minor Tait, Attorney for Defendant, Riley C. Garner, 150 East Court Street, Memphis, TN.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants

ANSWER OF THE DEFENDANT, RILEY C. GARNER, SHELBY COUNTY TRUSTEE

COMES NOW the defendant, Riley C. Garner, Shelby County Trustee, and in answer to the Complaint filed herein, says:

1. This defendant admits the allegations contained in Paragraph I of the Complaint.

2. This defendant admits the allegations contained in Paragraph II of the Complaint.

3. This defendant denies that the tax in question was erroneously, illegally and improperly assessed and collected. This defendant admits the remaining allegations contained in Paragraph III of the Complaint.

4. This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph IV of the Complaint.

5. This defendant admits the allegations contained in Paragraph V of the Complaint.

6. This defendant admits the allegations contained in Paragraph VI of the Complaint.

7. This defendant denies the allegations contained in Paragraph VII of the Complaint.

8. This defendant denies that 31 U.S.C. § 742 and U.S. Constitution Article VI are applicable to the tax in question and denies that he violated said statute and Constitution and denies that the tax in question violates said statute and Constitution.

9. This defendant denies the allegations contained in Paragraph IX of the Complaint.

10. All allegations contained in the Complaint not heretofore specifically answered, admitted or denied are here and now generally denied and denied as fully as though separately and specifically denied.

11. This defendant alleges that the tax provided for in T.C.A. § 67-751 is a non-discriminatory franchise or other non-property tax in lieu thereof and is, therefore, exempt from the provisions of 31 U.S.C. § 742.

AND, now having fully answered the Complaint, this defendant prays that said suit be dismissed and that he be allowed to go hence with his costs.

/s/ J. Minor Tait, Jr.
J. Minor Tait, Jr.
Assistant County Attorney
150 East Court Avenue
Memphis, Tennessee 38103
901/526-0606

/s/ Carl N. Stokes by J. M. T.
Carl N. Stokes
Assistant County Attorney
Suite 777 - 6263 Poplar
Memphis, Tennessee 38138
901/767-7750

Attorneys for Defendant, Riley C. Garner, Shelby County Trustee

CERTIFICATE OF SERVICE

I, J. Minor Tait, Jr., hereby certify that I have on this 26th day of September, 1979, mailed a true and correct copy of the foregoing Answer of the Defendant, Riley C. Garner, Shelby County Trustee, to David C. Scruggs, Attorney for Plaintiff, 900 Memphis Bank Building, Memphis, Tennessee 38103, and to William C. Bateman, Jr., Attorney for Defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, NBC Bank Building, Memphis, Tennessee 38103.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

AMENDED COMPLAINT

Comes now the Plaintiff, Memphis Bank & Trust Company, and amends its Complaint pursuant to Consent Order heretofore entered, by deleting Section IX and substituting in the place thereof the following Section IX:

IX.

The Defendants have assessed and collected taxes based on the "net earnings" of the Plaintiff. Tax exempt interest from Federal obligations constituted a portion of the "net earnings" so taxed.

In 1976, the base year for the 1977 Intangible Personal Property Tax, Memphis Bank & Trust Company had total taxable income for purposes of computation of this tax of $1,389,522; however, included in that amount was interest on obligations of the United States in the amount of $3,176,116. In 1977, the base year for the 1978 Intangible Personal Property Tax, Memphis Bank & Trust Company's taxable income was $1,505,424; however, included in that amount was interest on obligations of the United States in the amount of $3,575,667. If these amounts had been excluded pursuant to 31 U.S.C. § 742, there would have been no net earnings of the Plaintiff and, therefore, no Intangible Personal Property Tax.

Therefore, by assessing and collecting taxes based on taxable income which includes exempted United States interest, the Defendants have erroneously, illegally and improperly carried

out their duties and Plaintiff has been wrongfully assessed, the taxes unlawfully required to be paid, and Plaintiff is entitled to recover them in this action. Such assessment and collection violates the Federal exemption statute, 31 U.S.C. § 742, and is unconstitutional under the Supremacy Clause of the United States Constitution. U.S. CONST., art. VI.

The Complaint shall remain in all other respects as heretofore filed.

COBB, EDWARDS, NICHOL, WOODALL & KELLY

/s/ DAVID C. SCRUGGS
David C. Scruggs (W-629)
Attorney for Plaintiff
900 Memphis Bank Building
Memphis, Tennessee 38103
(901) 525-6781

Certificate of Service

I, David C. Scruggs, hereby certify that copies of the foregoing Amended Complaint have been served upon the Honorable William Leech, Jr., Attorney General of the State of Tennessee, pursuant to Rule 24.04 of the Tennessee Rules of Civil Procedure; to J. Minor Tait, Jr., Esq., Attorney for Defendant, Riley C. Garner, Shelby County Trustee; and to William C. Bateman, Esq., Attorney for Defendant, Glenn E. Foster, Treasurer of the City of Memphis, by mailing a copy of same to their respective business addresses by U.S. Mail, postage prepaid this 3rd day of June, 1980.

/s/ DAVID C. SCRUGGS

IN THE CHANCERY COURT OF SHELBY COUNTY
FOR THE TENTH CHANCERY DIVISION OF TENNESSEE

No. 85780
Part 3

MEMPHIS BANK AND TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

ANSWER OF RILEY C. GARNER, SHELBY COUNTY TRUSTEE, TO PLAINTIFF'S FIRST AMENDED COMPLAINT

COMES NOW the Defendant, Riley C. Garner, Shelby County Trustee, by and through his attorney of record, and for Answer to the Amended Complaint filed herein, says:

1. This Defendant denies the allegations contained in Paragraph 9 of the Amended Complaint.

2. For further answer, this Defendant relies upon and incorporates by reference here in its Answer to the original Complaint.

And now having fully answered the Amended Complaint, this Defendant prays that said suit be dismissed and that he be allowed to go hence with his costs.

By: _____

J. Minor Tait, Jr.
Assistant County Attorney
150 East Court Avenue
Memphis, Tennessee 38103
901-526-0606

Carl N. Stokes
Assistant County Attorney
Suite 777 — 6263 Poplar Avenue
Memphis, Tennessee 38138
901-767-7750

Attorneys for Defendant, Riley C. Garner, Shelby County Trustee

CERTIFICATE OF SERVICE

I, J. Minor Tait, Jr., hereby certify that I have on this ____ day of _____ , 1980, mailed a true and correct copy of the foregoing Answer of the Defendant, Riley C. Garner, Shelby County Trustee, to David C. Scruggs, Attorney for Plaintiff, 900 Memphis Bank Building, Memphis, Tennessee 38103, and to William C. Bateman, Jr., Attorney for Defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, NBC Bank Building, Memphis, Tennessee, 38103.

J. Minor Tait, Jr.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff

v.

RILEY C. GARNER, et al.,

Defendants

ANSWER OF GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE TO PLAINTIFF'S FIRST AMENDMENT TO COMPLAINT

Defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, for answer to plaintiff's first amendment to complaint says:

1. This defendant denies the allegations contained in Paragraph 9 of the amendment to complaint.

2. For further answer, this defendant relies upon and incorporates by reference herein, its answers to the original complaint.

Now having fully answered the amendment to complaint, this defendant prays that said suit be dismissed and that he be allowed to go hence at the cost of the plaintiff.

STAFF ATTORNEY FOR THE CITY OF MEMPHIS

ATTORNEY FOR DEFENDANT, GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE

CERTIFICATE OF SERVICE

The undersigned, an attorney for defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, hereby certifies that a copy of the foregoing Answer to amendment to complaint was mailed this ____ day of _____ , 1980 to David C. Scruggs, attorney for plaintiff, #900 Memphis Bank Building, Memphis, Tennessee 38103, and to J. Minor Tait, Jr., attorney for defendant, Riley C. Garner, 130 West Court Avenue, Memphis, Tennessee 38103.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY

Plaintiff

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE

Defendant

ANSWER

Comes William M. Leech, Jr., Attorney General for the State of Tennessee, appearing for the purpose of defending the constitutionality of statutes challenged in this action, and for answer to the plaintiffs allegations that certain statutes are unconstitutional would show the court the following:

FIRST DEFENSE

In response to the allegations in the Complaint, the defendant would respond paragraph by paragraph as follows:

1. ADMITTED

2. ADMITTED

3. The defendant admits the type of action herein and the authority for suits to recover taxes paid under protest.

4. The defendant is without sufficient information, acknowledge, or belief to admit the allegations in Paragraph 4.

5. The defendant is without sufficient information, or belief to admit the allegations in Paragraph 5.

6. The statute speaks for itself.

7. The statute speaks for itself.

8. The statute and constitutional provision speak for themselves.

9. The defendant would aver that the taxes were assessed in the court of T.C.A. § 67-751 and that accordingly the taxes were measured by the "net earnings" of the plaintiff. The intervenor's without sufficient information or belief to admit or deny the amounts of interest in question.

The intervenor would aver that the taxes in question were assessed upon the intangible value of the bank shares owned by the plaintiff shareholders and that the value of said shares was measured by the net earnings of the plaintiff. The intervenor denies that the taxes in question were imposed upon the capital or the property of the plaintiff. Therefore the intervenor avers that the assessment and collection of said taxes did not contravene the provisions found in 31 U.S.C. Section 742. Further, T.C.A. § 67-751 et seq. does not violate the Supremacy Clause of the United States Constitution.

All other allegations not specifically admitted or denied are hereby denied.

SECOND DEFENSE

The intervenor avers that if T.C.A. § 67-751 et seq., is declared to be constitutionally invalid, then the previously valid taxing provisions found in T.C.A. § 67-715 et seq. are revived and remain in full force in effect. Therefore, the intangible personal property taxes assessed against the shares owned by the stockholders of the plaintiff is properly authorized and mandated.

Having fully answered, the intervenor moves the court to dismiss the Complaint.

/s/ JOE C. PEEL
Joe C. Peel
Assistant Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219
(615) 741-6431

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been forwarded to all parties of interest or counsel for said parties in this cause.

THIS 6th day of August, 1980.

/s/ JOE C. PEEL
Joe C. Peel
Assistant Attorney General

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

SECOND AMENDED COMPLAINT

Comes now the Plaintiff, Memphis Bank & Trust Company, and amends its Complaint pursuant to Consent Order heretofore entered, by deleting Section IX of the Amended Complaint and adding as Sections IX, X, and XI the following:

IX

The Defendants have assessed and collected taxes based on the "net earnings" of the Plaintiff. Tax exempt interest from Federal obligations constituted a portion of the "net earnings" so taxed.

In 1976, the base year for the 1977 Intangible Personal Property Tax, Memphis Bank & Trust Company had net earnings for purposes of computation of this tax of $1,389,522; however, included in that amount was interest on obligations of the United States in the amount of $2,939,201 which was composed of the following:

$928,219 from United States Treasury Notes,

$216,984 from United States Treasury Bills,

$1,793,998 from various United States agencies, as follows:

Federal Land Bank — bond interest	$1,247,095
Federal Intermediate Credit Bank — bond interest	546,903

In 1977, the base year for the 1978 Intangible Personal Property Tax, Memphis Bank & Trust Company had net earnings for purposes of computation of this tax of $1,505,424; however, included in that amount was interest on obligations of the United States in the amount of $3,395,951 which was composed of the following:

$804,262 from United States Treasury Notes,

$44,536 from United States Treasury Bills,

$2,547,153 from various Unted States agencies, as follows:

Federal Land Bank — bond interest	$1,625,602
Federal Intermediate Credit Bank — bond interest	$656,551
Banks for Cooperatives bond interest	$265,000

If these amounts had been excluded pursuant to 31 U.S.C. § 742, there would have been no net earnings of the Plaintiff and, therefore, no Intangible Personal Property Tax.

X

United States Treasury Notes, United States Treasury Bills, as well as obligations of Banks for Cooperatives, Federal Intermediate Credit Banks, and Federal Land Banks, the interest from which being included in the computation of the Tennessee Bank Tax, Tennessee Code Annotated § 67-751 (Supp. 1979), are U.S. obligations and thus expressly exempted from state, municipal, or local taxation by 31 U.S.C. § 742 (1976). Specific Congressional enactments authorizing the issuance of notes, bonds, and participation certificates by the named agencies also exempt such obligations from all state, municipal, and local taxation.

In reference to obligations and interest thereon issued by Banks for Cooperatives, 12 U.S.C. § 2134 (Supp. 1980) mandates in pertinent part:

> Each bank for cooperatives and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such bank shall be exempt, both as to principal and interest from all taxation (except surtaxes, estate, inheritance and gift taxes) now or hereafter

> imposed by the United States or any State, territorial or local taxing authority. . . . [I]nterest on the obligations of such banks shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941. . . .

In reference to obligations, and interest thereon, issued by Federal Intermediate Credit Banks, 12 U.S.C. § 2079 (Supp. 1980) specificies in pertinent part:

> The obligations held by the Federal intermediate credit banks and the notes, bonds, debentures, and other obligations issued by the banks shall be deemed to be instrumentalities of the Government of the United States, and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (section 742a of Title 31).

In reference to obligations, and interest thereon, issued by Federal Land Banks, 12 U.S.C. § 2055 mandates in pertinent part:

> The mortgages held by the Federal land banks and the notes, bonds, debentures, and other obligations issued by the banks or associations shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (section 742a of Title 31).

The above acts — 12 U.S.C. § 2134, 12 U.S.C. § 2079, and 12 U.S.C. § 2055 — expressly exclude from state, municipal, or local taxation the obligations and interest thereon comprising part of the Plaintiff's portfolio that was included by Defendants in computation of the Tennessee Bank Tax.

XI

In conclusion, Plaintiff, Memphis Bank & Trust Company, contends:

a) Federal law, 31 U.S.C. § 742 (1976), construed together with the Tennessee Bank Tax, Tenn. Code Ann. § 67-751 (Supp. 1979), mandates the exclusion of U.S. obligations and interest thereon from the computation of the Tennessee Bank Tax. 12 U.S.C. § 2134 (Supp. 1980), 12 U.S.C. § 2079 (Supp. 1980), and 12 U.S.C. § 2055 (Supp. 1980), establish that obligations of Banks for

Cooperatives, Federal Intermediate Credit Banks, and Federal Land Banks, as well as United States Treasury Notes and Bills, are U.S. obligations and thus within the purview of 31 U.S.C. § 742 expressly exempting from state, municipal, or local taxation "all stocks, bonds, Treasury notes, and other obligations of the United States." Although Tenn. Code Ann. § 67-751 does not expressly exclude U.S. obligations and interest thereon from its computation formula, such exclusion is by virtue of the Supremacy Clause and 31 U.S.C. § 742 a necessary construction of the Bank Tax.

b) In the alternative, Plaintiff reserves its right to challenge the constitutionality of the Tennessee Bank Tax, Tenn. Code Ann. § 67-751, as applied to the facts before this Court. Plaintiff's contention is not at this time that the Tennessee Bank Tax is unconstitutional in its entirety, but that in its application to Plaintiff and in its imposition of a tax upon the U.S. obligations and interest thereon in Plaintiff's portfolio, the Bank Tax violates 31 U.S.C. § 742 and the Supremacy Clause.

c) In its alternative contention, Plaintiff recognizes that the Bank Tax might be imposed against banks without U.S. obligations or interest thereon, but that the Supremacy Clause forbids imposition of the tax on the present Plaintiff to the extent of the inclusion of U.S. obligations and interest thereon in the computation of the tax.

Therefore, by assessing and collecting taxes based on net earnings which includes exempted United States interest, the Defendants have erroneously, illegally and improperly carried out their duties and Plaintiff has been wrongfully assessed, and the taxes unlawfully required to be paid, and Plaintiff is entitled to recover them in this action.

The Complaint shall remain in all other respects as heretofore filed.

COBB, EDWARDS, NICHOL, WOODALL & KELLY

/s/ DAVID C. SCRUGGS (W-629)
David C. Scruggs
Attorney for Plaintiff
900 Memphis Bank Building
Memphis, Tennessee 38103
901/525-6781

CERTIFICATE OF SERVICE

I, David C. Scruggs, hereby certify that copies of the foregoing Second Amended Complaint have been served upon the Honorable Joe C. Peel, Assistant Attorney General of the State of Tennessee, pursuant to Rule 24.04 of the Tennessee Rules of Civil Procedure; to J. Minor Tait, Jr., Esq., Attorney for Defendant, Riley C. Garner, Shelby County Trustee; and to William C. Bateman, Esq., Attorney for Defendant, Glenn E. Foster, Treasurer of the City of Memphis, by mailing a copy of same to their respective business addressed by U.S. Mail, postage prepaid, this 11 day of September, 1980.

/s/ DAVID C. SCRUGGS

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff.

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

ANSWER OF THE DEFENDANT, RILEY C. GARNER TO PLAINTIFF'S SECOND AMENDED COMPLAINT

COMES NOW the Defendant, Riley C. Garner, by and through his attorneys of record, and for answer to the Second Amended Complaint filed herein, says:

1. This Defendant admits the allegations contained in Paragraph I of the Amended Complaint.

2. This Defendant admits the allegations contained in Paragraph II of the Amended Complaint.

3. This Defendant denies that the tax in question was erroneously, illegally and improperly assessed and collected. This Defendant admits the remaining allegations contained in Paragraph III of the Amended Complaint.

4. This Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph IV of the Amended Complaint, and therefore denies said allegations and demands strict proof thereof.

5. This Defendant admits the allegations contained in Paragraph V of the Amended Complaint.

6. This Defendant admits the allegations contained in Paragraph VI of the Amended Complaint

7. This Defendant denies the allegations contained in Paragraph VII of the Amended Complaint.

8. This Defendant denies that 31 U.S.C. § 742 and U.S. Constitution Article VI are applicable to the tax in question and denies that he violated said Statutes and Constitution and denies that the tax in question violates said Statutes and Constitution.

9. This Defendant would show that the assessment and collection of taxes herein was based upon the "net earnings" of Memphis Bank & Trust Company as certified by the Commissioner of Revenue to the Division of Property Assessment. This Defendant denies all other allegations contained in Paragraph IX of the Amended Complaint.

10. This Defendant admits that the State and Federal Statutes cited and set forth in part in Paragraph X of the Amended Complaint had been enacted and were in full force and effect at all times relevant hereto. This Defendant denies all other allegations contained in Paragraph X of the Amended Complaint.

11. This Defendant denies the allegations contained in Paragraph XI of the Amended Complaint.

12. All allegations contained in the Amended Complaint not heretofore admitted or denied are hereby denied as though set forth and specifically denied.

13. For further answer, this Defendant alleges in the alternative that the tax provided for in *Tenn. Code Ann.* § 67-751 is a non-discriminatory franchise or other non-property tax in lieu thereof and is, therefore, exempt from the provisions of 31 U.S.C. § 742.

14. For further answer, this Defendant alleges in the alternative that *Tenn. Code Ann.* § 67-751 *et seq.*, was designed and enacted to amend or supersede the pre-1977 provisions of Chapter 7, Title 67 of the Tennessee Code Annotated pertaining to bank taxation. In the event that this Court finds that *Tenn. Code Ann.* § 67-751 *et seq.*, is unconstitutional, the former valid taxing Statute remains in full force and effect, and Memphis Bank & Trust Company is subject to the assessment and collection of taxes under the former Statute.

15. This Defendant hereby reserves his right to file a Counter-Claim for a Declaratory Judgment, alleging the revival of the former taxing Statute, *Tenn. Code Ann.* § 67-715 *et seq.* (1976), as it existed prior to the 1977 enactment of the present statute, *Tenn. Code Ann.* § 67-751 *et seq.*, in the event that this Court declares the present statute unconstitutional.

AND NOW, having fully answered the Second Amended Complaint, the Defendant, Riley C. Garner, prays that said suit be dismissed and that he be allowed to go hence with his costs.

Respectfully submitted,

McDONALD, KUHN, SMITH, MILLER & TAIT

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.
Assistant County Attorney

/s/ MARY MARGARET WEDDINGTON
Mary Margaret Weddington
150 East Court Avenue
P.O. Box 3160
Memphis, Tennessee 38103
Telephone: (901) 526-0606

/s/ CARL N. STOKES by J.M.T.
Carl N. Stokes
Assistant County Attorney
6263 Poplar Avenue,
Suite 777
Memphis, Tennessee 38138
Telephone: (901) 767-7750

Attorneys for Defendant,
Riley C. Garner, Shelby
County Trustee

CERTIFICATE OF SERVICE

I, J. Minor Tait, Jr., do hereby certify that a copy of the foregoing Answer has been served upon Plaintiff by forwarding a copy thereof to David C. Scruggs, Attorney for Plaintiff, Suite 900, Memphis Bank Building, Memphis, Tennessee 38103; William C. Bateman, Jr., Attorney for Defendant, Glenn E. Foster, Suite 1100, One Commerce Square, Memphis, Tennessee 38103; and The Honorable Joe C. Peel, Assistant Attorney General of the State of Tennessee, 450 James Robertson Parkway, Nashville, Tennessee 37219, this 14th day of October, 1980.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK AND TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

Stipulation

TO THE HONORABLE D. J. ALISSANDRATOS, CHANCELLOR, PART III, OF THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE:

The parties hereto stipulate the following facts:

1. On January 4, 1979, Plaintiff paid under protest to Defendant Glenn E. Foster, Treasurer of the City of Memphis, the sums of Fourteen Thousand, Forty-Eight and 43/100 Dollars ($14,048.43) representing intangible personal property taxes for the year 1977 and Thirteen Thousand, One Hundred Sixty-Six and 04/100 Dollars ($13,166.04) representing intangible personal property taxes for the year 1978.

2. Plaintiff paid under protest to Defendant Riley C. Garner as Shelby County Trustee on January 11, 1979 the sum of Fifteen Thousand, Two Hundred Nineteen and 13/100 Dollars ($15,219.13) representing the intangible personal property taxes for the year 1977 and on January 8, 1979, the sum of Fourteen Thousand, Two Hundred Sixty-Three and 21/100 Dollars ($14,263.21) representing intangible personal property taxes for the year 1978.

3. In 1976, the base year for the 1977 intangible personal property tax, Memphis Bank & Trust Company had "net earnings"

for purposes of the intangible personal property tax of One Million, Three Hundred Eighty-Nine Thousand, Five Hundred Twenty-Two Dollars ($1,389,522). Included in that amount was "interest on obligations of the United States and U.S. instrumentalities" as reported on line 5 of its 1976 U.S. Corporation Income Tax Return in the amount of Three Million, One Hundred Seventy-Six Thousand, One Hundred Sixteen Dollars ($3,176,116) composed of the following:

(a) $928,219 from U.S. Treasury Notes,

(b) $216,984 from U.S. Treasury Bills,

(c) $2,030,913 from various United States agencies as follows:

Federal Land Bank	$1,247,095
Federal Intermediate Credit Bank	$ 546,904
Farmers Home Administration	$ 88,576
Federal National Mortgage Association	$ 148,338

4. In 1977, the base year for the 1978 intangible personal property tax, Plaintiff's "net earnings" for purposes of the intangible personal property tax was One Million, Five Hundred Five Thousand, Four Hundred Twenty-Four Dollars ($1,505,424). Included in that amount was "interest on obligations of the United States and U.S. instrumentalities" as reported on line 5 of its 1977 U.S. Corporation Income Tax Return of Three Million, Five Hundred Seventy-Five Thousand, Six Hundred Sixty-Seven Dollars ($3,575,667) composed of the following:

(a) $804,262 from U.S. Treasury Notes,

(b) $44,536 from U.S. Treasury Bills,

(c) $2,726,869 from various United States agencies as follows:

Federal Land Bank	$1,625,602
Federal Intermediate Credit Bank	$ 656,551
Banks for Cooperatives	$ 265,000
Farmers Home Administration	$ 88,365
Federal National Mortgage Association	$ 91,351

5. Plaintiff, Memphis Bank & Trust Company, paid intangible personal property taxes in the amount of Twenty-Nine Thousand, Two Hundred Sixty-Seven and 56/100 Dollars ($29,267.56) for the year 1977. The tax liability was computed as follows:

Net Earnings	$1,389,522.00
Times 3%	x .03
Gross Intangible Personal Property Tax	41,685.66
Less:	
Credit of 10% of Ad Valorem Taxes Paid by Memphis Bank & Trust	(12,418.10)
Total 1977 Intangible Personal Property Taxes Payable	$ 29,267.56

Memphis Bank & Trust Company paid the total 1977 tax liability in the amounts of Fourteen Thousand, Forty-Eight and 43/100 Dollars ($14,048.43) to the Defendant Treasurer of the City of Memphis and Fifteen Thousand Two Hundred Nineteen and 13/100 Dollars ($15,219.13) to the Defendant Shelby County Trustee.

6. Memphis Bank & Trust Company paid intangible personal property taxes in the amount of Twenty-Seven Thousand, Four Hun-

dred Twenty-Nine and 25/100 Dollars ($27,429.25) for the year 1978. The tax liability was computed as follows:

Net Earnings	$1,505,425.00
Times 3%	x .03
Gross Intangible Personal Property Tax	45,162.75
Less:	
Credit of 10% of Ad Valorem Taxes Paid by Memphis Bank & Trust Company	(17,733.50)
Total 1978 Intangible Personal Property Taxes Payable	$ 27,429.25

Memphis Bank & Trust Company paid the total 1978 tax liability in the amounts of Thirteen Thousand, One Hundred Sixty-Six and 04/100 Dollars ($13,166.04) to the Treasurer of the City of Memphis and Fourteen Thousand, Two Hundred Sixty-Three and 21/100 Dollars ($14,263.21) to the Shelby County Trustee.

7. Plaintiff's "net earnings" for the year 1976 the base of the 1977 intangible personal property tax, amounted to One Million, Three Hundred Eighty-Nine Thousand, Five Hundred Twenty-Two Dollars ($1,389,522). If the following amounts of interest from the named sources is excluded from "net earnings", Memphis Bank & Trust Company's "net earnings" is less than $0; therefore, there would be no 1977 intangible personal property tax liability.

United States Treasury Notes	$928,219
United States Treasury Bills	$216,984
Federal Land Bank	$1,247,095
Federal Intermediate Credit Bank	$546,904
TOTAL	$2,939,202

8. Plaintiff's "net earnings" for the year 1977, the base of the 1978 intangible personal property tax, amounted to One Million, Five Hundred Five Thousand, Four Hundred Twenty-Four Dollars ($1,505,424). If the following amounts of interest from the named sources is excluded from "net earnings", Memphis Bank & Trust Company's "net earnings" is less than $0; therefore, there would be no 1978 intangible personal property tax liability.

United States Treasury Notes	$804,262
United States Treasury Bills	$44,536
Federal Land Bank	$1,625,602
Federal Intermediate Credit Bank	$656,551
Banks for Cooperatives	$265,000
TOTAL	$3,395,951

9. Debentures of the Federal National Mortgage Association and Farmers Home Administration are not treated as United States obligations. Interest received by Plaintiff from such obligations is properly includable in "net earnings", the base of the intangible personal property tax, without violating the Federal Exemption Statute of 31 U.S.C. § 742 or other federal statutes.

10. The Tennessee Franchise and Excise Tax returns for the years 1976 and 1977 for Memphis Bank & Trust Company are hereby stipulated into evidence as collective exhibit 1 with authority to substitute copies of the original tax returns which are in the possession of the Internal Revenue Service and Tennessee Department of Revenue, respectively.

This Stipulation agreed to between the parties this 23 day of October, 1980.

COBB, EDWARDS, NICHOL, WOODALL & KELLY

/s/ DAVID C. SCRUGGS
David C. Scruggs
Attorney for Plaintiff

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.
Attorney for Defendant,
Riley C. Garner,
Shelby County Trustee

/s/ WILLIAM C. BATEMAN by J. M. T.
William C. Bateman
Attorney for Defendant,
Glenn E. Foster, Treasurer
of the City of Memphis

/s/ JOE C. PEEL by Mary M. Weddington
Joe C. Peel
Assistant Attorney General,
Intervening on Behalf
of Defendant

*The stipulation included as exhibits the Franchise and Excise Tax Returns filed by Appellant with the Tennessee Department of Revenue. Since this information was stipulated, these forms are not included in this Appendix.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85789-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE, and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

AMENDED ANSWER AND COUNTER-CLAIM OF DEFENDANT RILEY C. GARNER, SHELBY COUNTY TRUSTEE, AND GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS

COME NOW the Defendants, Riley C. Garner, Shelby County Trustee, and Glenn E. Foster, Treasurer of the City of Memphis, and having obtained leave of Court, hereby amend their Answers heretofore filed to assert the following Counter-Claim.

COUNTER-COMPLAINT

AND NOW, having fully answered, the Defendants assume the role of Counter-Plaintiffs, and sue the Counter-Defendant, Memphis Bank & Trust Company, and for cause of action, say:

1. That the Court has jurisdiction under the Declaratory Judgment Statute, *Tenn. Code Ann.* § 23-1101 *et seq.*

2. That this Counter-Complaint arises out of the same facts and circumstances set forth in the Second Amended Complaint.

3. Prior to 1977, Memphis Bank & Trust Company, a state banking association, was subject to the provisions of *Tenn. Code Ann.* § 67-715 through § 67-736, providing for the assessment, payment, and collection of taxes on corporate and business property.

4. In 1977, banks were removed from the application of these statutes by amendments to *Tenn. Code Ann.* § 67-715, § 67-721, and

§ 67-726, and by repeal of *Tenn. Code Ann.* § 67-819. (1977 Tenn. Pub. Acts, Ch. 140 §§ 2, 5, 6, 7.) Beginning in 1977, banks have been and are now subject to the provisions of the Bank Tax, *Tenn. Code Ann.* § 67-751 through § 67-763. (1977 Tenn. Pub. Acts, Ch. 140 § 1.)

5. Memphis Bank & Trust Company has paid under protest to Counter-Plaintiffs those taxes assessed in conformity with *Tenn. Code Ann.* § 67-751 *et seq.* for the years 1977 and 1978. In its Complaint, Memphis Bank & Trust Company challenges the constitutionality of *Tenn. Code Ann.* § 67-751 *et seq.* and seeks refund of those taxes assessed and collected in accord with the statute.

6. The Counter-Plaintiffs allege that the Tennessee taxing statute, *Tenn. Code Ann.* § 67-751 *et seq.*, does not conflict with or violate the Federal Exemption Statute, 31 U.S.C. § 742, nor does it conflict or violate the provisions of 12 U.S.C. § 2134, 12 U.S.C. § 2079, or 12 U.S.C. § 2055 as alleged in the Second Amended Complaint. Therefore, the Tennessee taxing statute does not violate the Supremacy Clause of the United States Constitution, and the 1977 and 1978 taxes imposed upon Memphis Bank & Trust Company were legally, properly, and constitutionally assessed and collected.

7. In the alternative, the Counter-Plaintiffs allege that if the Tennessee taxing statute, *Tenn. Code Ann.* § 67-751 *et seq.*, is in violation of the Supremacy Clause of the United States Constitution, then the prior Tennessee taxing statute, *Tenn. Code Ann.* § 67-715 *et seq.* (1976), which was amended and revised upon the enactment of the present statute, is automatically revived and its provisions imposed upon and applied to Memphis Bank & Trust Company commencing with the 1977 tax year, which was the year of the restructuring the bank taxing statutes.

WHEREFORE, PREMISES CONSIDERED, the Counter-Plaintiffs sue the Counter-Defendant for declaratory relief as to the constuction of and validity of *Tenn. Code Ann.* § 67-751 *et seq.* and for a declaration of the rights and status of the parties thereunder, and prays:

a. That this Court enter Judgment declaring that the Tennessee Bank Tax, *Tenn. Code Ann.* § 67-751 *et seq.*, is constitutional and that Counter-Defendant is not entitled to a refund of taxes assessed and collected in accord with said statute.

b. That, in the alternative, this Court enter a Judgment declaring that because this Court has found that the Tennessee Bank Tax, *Tenn. Code Ann.* § 67-751 *et seq.* is unconstitutional or unconstitutionally applied, the prior valid state taxing statute, *Tenn. Code Ann.* § 67-715 *et seq.* (1976), is revived and applicable to the Counter-Defendant commencing with the 1977 tax year.

c. That the Counter-Plaintiffs have any and all other relief to which they may be entitled, together with the costs of this cause.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.
Assistant County Attorney

/s/ MARY MARGARET WEDDINGTON
Mary Margaret Weddington
150 East Court Avenue
P.O. Box 3160
Memphis, Tennessee 38103
Telephone: (901) 526-0606

/s/ CARL N. STOKES by J.M.T.
Carl N. Stokes
Assistant County Attorney
6263 Poplar Avenue,
Suite 777
Memphis, Tennessee 38138
Telephone: (901) 767-7550

Attorneys for Defendant, Riley C. Garner, Shelby County Trustee

/s/ WILLIAM C. BATEMAN, JR., by J.M.T.
William C. Bateman, Jr.
Attorney for Defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee

CERTIFICATE OF SERVICE

I, J. Minor Tait, Jr., do hereby certify that a copy of the foregoing Amended Answer and Counter-Claim has been served upon Plaintiff by hand delivering a copy thereof to David C. Scruggs, Attorney for Plaintiff, Suite 900, Memphis Bank Building, Memphis, Tennessee 38103; and by mailing a copy thereof to The Honorable Joe C. Peel, Assistant Attorney General of the State of Tennessee, 450 James Robertson Parkway, Nashville, Tennessee 37219, this 3rd day of November, 1980.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants.

REPLY TO DEFENDANTS' COUNTERCLAIM

Comes now the Plaintiff, Memphis Bank & Trust Company, and in reply to the Defendants' Counterclaim filed herein, says:

1. The allegations in paragraph 1 of the Defendants' Counter-complaint are admitted.

2. The allegations in paragraph 2 of the Defendants' Counter-complaint are denied.

3. The allegations in paragraph 3 of the Defendants' Counter-complaint are admitted.

4. The allegations in paragraph 4 of the Defendants' Counter-complaint are admitted.

5. Plaintiff, Memphis Bank & Trust Company, admits that it has paid under protest to Defendants those taxes assessed in conformity with Tenn. Code Ann. § 67-751 *et seq.* (Supp. 1980) for the years 1977 and 1978. In its Complaint, Memphis Bank & Trust Company demands the refund of those taxes assessed and collected pursuant to the statute on the basis that the statute must be construed so as to not require the inclusion of interest on federal obligations in the computation of the tax. The basic thrust of the Complaint is not a constitutional attack on the statute but a contention that the statute should be construed to comply with federal law or, in the alternative, that federal law has preempted and should control. Only as a final

alternative does Plaintiff contend that the statute is unconstitutional and then only unconstitutional *as applied*.

6. Plaintiff neither admits nor denies the allegations contained in paragraph 6 of the Counter-complaint because they are not proper pleadings but rather expressions of legal conclusions.

7. All allegations contained in paragraph 7 of the Counter-complaint are denied. For further reply, Plaintiff, Memphis Bank & Trust Company, alleges that Tenn. Code Ann. § 67-751 (Supp. 1980) is challenged only as it applies in this instance where federally exempted interest is included in the base of the tax. The language set out below contained in chapter 140 of the Public Acts of 1977 which enacted Tenn. Code Ann. § 67-751 (Supp. 1980) refutes the allegations made by Defendants in paragraph 7 of their Counter-complaint.

> Section 9. If any provision of this Act or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of this Act which can be given effect without the invalid provision or application, and to that end, the provisions of this Act are declared to be severable.

On the basis of the foregoing allegations, the Plaintiff demands judgment:

(a) That the Defendants' Counterclaim be dismissed;

(b) That relief should be granted Plaintiff in accordance with its Complaints and Memorandums in support thereof filed in this cause.

/s/ DAVID C. SCRUGGS
David C. Scruggs

/s/ ANDREW H. RAINES
Andrew H. Raines

Attorneys for Plaintiff

COBB, EDWARDS, NICHOL,
WOODALL & KELLY
900 Memphis Bank Building
Memphis, Tennessee 38103
901/525-6781

CERTIFICATE OF SERVICE

I, David C. Scruggs, do hereby certify that a copy of the foregoing Reply to Defendants' Counterclaim has been served upon Defendants by forwarding a copy thereof to J. Minor Tait, Jr., Attorney for Defendant, Riley C. Garner, Shelby County Trustee, 150 East Court Avenue, Memphis, Tennessee 38103, William C. Bateman, Jr., Attorney for Defendant, Glenn E. Foster, Treasurer, City of Memphis, Suite 1100, One Commerce Square, Memphis, Tennessee 38103, and The Honorable Joe C. Peel, Assistant Attorney General, State of Tennessee, 450 James Robertson Parkway, Nashville, Tennessee 37219, this 26th day of November, 1980.

/s/ DAVID C. SCRUGGS
David C. Scruggs

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY

Plaintiff

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants

AFFIDAVIT OF ROGER G. MURRAY, JR.

STATE OF TENNESSEE
MADISON COUNTY

COMES NOW Roger G. Murray, Jr., who first being duly sworn, deposes and says:

1. I am Roger G. Murray, Jr. I was Chairman of the Special Committee created pursuant to House Joint Resolution Number 428 for the study of intangible taxation.

2. Pursuant to the mandate of House Resolution Number 428, this Committee scheduled and held public hearings, obtained testimony, and made specific findings which were compiled in its final report and recommendation which was submitted to the Tennessee Ninetieth General Assembly. A true and correct copy of said final report and recommendation is attached hereto as Exhibit 1 to this Affidavit.

3. This Committee also filed with the Executive Secretary of the State Board of Equalization a copy of the comprehensive summary of testimony and information before the Committee. A true and

correct copy of said comprehensive summary is attached hereto as Exhibit II to this Affidavit.

Further Affiant sayeth not.

/s/ ROGER G. MURRAY, JR.
Roger G. Murray, Jr.

SWORN TO AND SUBSCRIBED before me this 12th day of December, 1980.

My Commission Expires

9/18/84

/s/ BUTLER PATTERSON
Butler Patterson
Notary Public

EXHIBIT I

FINAL REPORT OF SPECIAL COMMITTEE FOR THE STUDY OF INTANGIBLE PERSONAL PROPERTY TAXATION

Submitted to the 90th General Assembly of The State of Tennessee

PURSUANT TO HOUSE JOINT RESOLUTION NO. 428

Nashville, Tennessee March 1977

THE RESOLUTION ESTABLISHING THE SPECIAL COMMITTEE FOR THE STUDY OF INTANGIBLE TAXATION

HOUSE JOINT RESOLUTION NO. 428

A RESOLUTION authorizing the appointment of a special joint committee to study the laws relating to taxation of intangible personal property and the laws relating to taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions and to report to the Ninetieth General Assembly.

WHEREAS, the people of Tennessee approved an amendment to Article 2, Section 28, of the Constitution of Tennessee in August 1972; and

WHEREAS, the State Constitution, as amended, delegates certain powers to the Legislature relative the subclassification and assessment of intangible personal property and the assessment and taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions; and

WHEREAS, the State Board of Equalization has conducted certain studies and has made certain reports and recommendations to the General Assembly pursuant to Chapter 226 of the Public Acts 1973; and

WHEREAS, the reports prepared by the State Board of Equalization show that there is great disparity and lack of uniformity in the manner

in which intangible personal property assessments have been administered across the state; and

WHEREAS, certain information has been presented which indicates that present laws impose an unfair burden of taxation upon banks and financial institutions in comparison with other corporations doing business in the state; and

WHEREAS, House Bill 1834 and its companion, Senate Bill 2072, were introduced in the 1976 session of the Eighty-Ninth General Assembly; and

WHEREAS, considerable concern has been raised regarding the financial impact upon local governments in Tennessee which would result if said bills were enacted into law; and

WHEREAS, it is in the public interest that further study and attention be given to these matters; now, therefore,

BE IT RESOLVED BY THE HOUSE OF REPRESENTATIVES OF THE EIGHTY-NINTH GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, THE SENATE CONCURRING, That a special committee is hereby created which shall be composed of three members of the Senate and three members of the House, to be appointed by the respective speaker of each house; two members of the State Board of Equalization, to be elected by said Board; and three members from the public at large, to be appointed by the Governor, to further study the laws relating to the subclassification, assessment and taxation of intangible personal property and the laws relating to the assessment and taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions. Such committee shall report its findings and recommendations to the Ninetieth General Assembly no later than January 15, 1977;

Senators and Representatives who are members of the committee shall receive the same per diem and mileage allowance reimbursement for attending meetings of the committee as provided by general law for attendance at legislative committee meetings;

Members of the committee appointed from the public at large shall be paid at the rate of Fifty Dollars ($50.00) per day for each day or part of a day in attendance at meetings of the committee and shall be reimbursed necessary travel and expenses as prescribed in the Comprehensive Travel Regulations by the Commissioner of Finance and Administration for employees of the State of Tennessee; and

All necessary and proper expenses incurred by said committee in the performance of its duties imposed under this resolution, except per diem and mileage allowance reimbursement incurred by Senators and Representatives and other full-time state officials who are members of the committee, shall be paid out of the funds appropriated or made available to the State Board of Equalization or the State Division of Property Assessments, as shall be approved by the Comptroller of the Treasury. The State Board of Equalization is authorized to employ such staff and provide such assistance to said committee as may be deemed necessary from such funds.

MEMBERS OF COMMITTEE AND STAFF

Committee Members

The Honorable Roger G. Murray, Jr.
State Representative, Jackson, TN
Chairman

The Honorable Charlie R. Ashford
State Representative, Memphis, TN
Vice Chairman

The Honorable Ben Hooper
State Senator
Newport, TN

The Honorable Milton Hamilton
State Senator, Union City, TN

The Honorable Eugene E. Davidson
State Representative, Springfield, TN

The Honorable Joe H. Hemphill
Commissioner, Department of Banking

Mr. Dave A. Alexander
Franklin, TN

Mr. James Alexander
Nashville, TN

Mr. Ben Kimbrough
Clarksville, TN

The Honorable William O. Beach
Montgomery County Judge
Clarksville, TN

The Honorable Harlan Mathews
State Treasurer

Staff of State Board of Equalization

David Whitefield
Executive Secretary

Jerry Shelton
Staff Attorney

Pat Clark
Supervisor of Research

Christine Wolf
Staff Attorney

Gary Gatten
Research Analyst

HOUSE STATE AND LOCAL GOVERNMENT COMMITTEE

Room 35, Legislative Plaza
Nashville, Tennessee 37219
741-4881

March 28, 1977

Members of the 90th General Assembly
State Capitol
Nashville, Tennessee 37219

Honorable Fellow Members:

The Special Committee for the Study of Intangible Personal Property Taxation herewith submits its Final Report and Recommendations for your consideration. In your Resolution creating this Committee you directed that we study the laws relating to the subclassification, assessment and taxation of intangible personal property and the laws relating to assessments and taxation of bank insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions.

This Report has purposely been limited to the findings and recommendations unanimously adopted by the Committee. A copy of the Comprehensive Summary of Testimony and Information Before the Committee can be obtained from the Executive Secretary of the State Board of Equalization upon request. Although most of the public attention has been focused upon the taxation of bank shares which constitutes a substantial amount of intangible personal property taxes levied across the State, the Committee has endeavored to carry out its responsibilities relating to other financial institutions.

I wish to express my appreciation to each member of the Special Committee for his time and diligent efforts devoted to this study. Acknowledgement is also made to the staff of the State Board of Equalization as well as to all persons who appeared in hearings before the Committee for their valuable assistance.

Yours truly,

/s/ ROGER G. MURRAY, JR.
Roger G. Murray, Jr.
Committee Chairman

COMMITTEE REPORT AND RECOMMENDATIONS

Pursuant to House Joint Resolution No. 428 adopted by the Eighty-Ninth General Assembly, the special joint committee has conducted a study of the laws relating to the taxation of intangible personal property and the laws relating to the taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions. The Committee was assisted in this study by the staff of the State Board of Equalization.

Extensive information was compiled relating to the background and legislative history of our present laws, the manner in which these laws have been enforced throughout the state, and the practices of other states with respect to the taxation and exemption of intangible personal property. Public hearings were held in which representatives of these financial institutions appeared and made presentations. In addition, the Committee heard presentations from representatives of local governments throughout the state.

After careful consideration of all of the information and testimony before the Committee, the following findings have been adopted:

1. Banks in Tennessee are subject to the same taxes which all other corporations pay. These taxes include excise, franchise, real property and tangible personal property taxes. In addition to these taxes, banks pay intangible personal property taxes based on the value of the shares of stock. Although this is a tax on the shares of stock as the personal property of the shareholder, Tennessee Code Annotated, Section 67-727 requires payment of the tax to be made by a bank rather than its shareholders.

2. The results of this tax upon the shares of stock of banks in Tennessee are:

   (A) The total state and local taxes of a bank is approximately two (2) times the total state and local taxes paid by other comparable regular corporations.

   (B) The total state and local taxes for Tennessee banks are more than two (2) times the average total taxes paid by banks in eleven (11) other southeastern states.

   Although the committee has determined that it is proper for banks to be taxed at a higher rate of taxation than other

corporations because of certain privileges they enjoy, it does conclude that the current laws of Tennessee impose an excessive burden of taxation upon banks.

3. Intangible personal property assessments of banks have not been uniformly made across the state. The State Board of Equalization has recently taken steps to make uniform assessments of bank stock; however, reports to the Board show that the following number of counties have imposed intangible personal property taxes upon bank stock since 1973: 28 counties in 1973; 33 counties in 1974; 64 counties in 1975; and 68 counties in 1976. Even in counties where this tax has been imposed there has been disparity among the assessments of banks within the same counties.

4. The present scheme of taxing bank shares is contrary to public policy because regulation and supervision by state and federal authorities often require that banks increase their capitalization to protect the interest of their depositors and assure financial soundness. The current manner of taxing bank shares discourages a strong capital structure and particularly penalizes banks which are less than five (5) years old and are required to maintain higher capital ratios. The Committee concludes that an excise tax based upon net earnings would be more equitable and appropriate than the current scheme of taxing the shares of bank stock.

5. In changing from the present system of taxing bank shares to an excise tax based upon net earnings, a minimum tax calculated on an ad valorem basis of the value of the stock should be provided whereby local governments do not incur losses of taxes from this source of revenue.

6. Insurance companies in Tennessee are presently paying intangible personal property taxes in an amount which has been determined to approximate the national average of intangible personal property taxes imposed upon insurance companies by other states.

7. Although representatives of savings and loan associations presented evidence to indicate that their total taxes in Tennessee may be reaching burdensome proportions, the shares of stock of these companies are not presently taxed under Tennessee Code Annotated, Section 67-715.

8. Intangible personal property taxes are also imposed upon the shares of stock of loan companies, investment com-

panies and cemetary companies. Taxation of the capital of these corporations does not presently appear to be unfair and excessive; however, loan companies are the only financial institutions subject to taxes under the Business Tax Act.

In view of the foregoing conclusions the Committee recommends to the Ninetieth General Assembly that:

1. Legislation should be enacted to create a subclassification of intangible personal property which should be designated as the, "shares of banks and banking associations." In lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state should be required to pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real and tangible personal property for the next preceding year. The net earnings should be calculated in the same manner as prescribed by Tennessee Code Annotated, Title 67, Chapter 27.

2. In no event shall such excise tax be less than an ad valorem tax calculated on the basis of sixty percent (60%) of the book value of the bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter.

3. The tax of any bank which has been in business less than five (5) years shall be reduced proportionately at the rate of one-fifth (1/5) for each year less than five (5) it has been in business.

4. Unless the intangible personal property taxes are determined on the basis of sixty percent (60%) of the book value, the total tax shall be allocated between the county and municipality where the principal office of the bank is located in the same proportion as the property tax rate of each taxing jurisdiction for the immediately preceding year shall bear to the sum of said property tax rates of both taxing jurisdictions.

5. In order to facilitate the administration of this tax and to assure uniformity throughout the state, the State Division of Property Assessments should administer this tax.

6. The amount of taxes paid by loan companies under Tennessee Code Annotated, Title 67, Chapter 58, known as the Business Tax Act, should be deducted from the intangible personal property taxes imposed upon corporations under Tennessee Code Annotated, Section 67-715.

A comprehensive summary of the testimony and information presented to the Committee during its hearings and meetings, including the history, legislative background and practices of other states, has been filed with the Offices of the Lt. Governor and the Speaker of the House of Representatives. Upon request, the Executive Secretary of the State Board of Equalization will provide a copy of this summary to any interested senator or representative.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE
PART III

No. 85780-3

MEMPHIS BANK AND TRUST.

Plaintiff,

v.

SHELBY COUNTY, RILEY GARNER, *et al.*,

Defendants.

BE IT REMEMBERED, that the above-captioned cause came on to be heard at approximately 10:00 o'clock a.m., on the 19th day of December, 1980, in Part III of the above Court, before the HONORABLE D. J. ALISSANDRATOS, CHANCELLOR, presiding, when and where the following proceedings were had, to-wit:

APPEARANCES

For the Plaintiff:

DAVID C. SCRUGGS, ESQ.
Cobb, Edwards, Nichol, Woodall & Kelly
Suite 900
Memphis Bank Building
Memphis, Tennessee 38103

For the Defendant:

J. MINOR TAIT, JR., ESQ.
MISS MARY MARGARET WEDDINGTON
McDonald, Kuhn, Smith, Miller & Tait
2nd Floor, 150 East Court Ave.
Memphis, Tennessee 38103

For the State of Tennessee:

JOE C. PEEL, ESQ.
Assistant Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219

THE COURT: I wish to again thank y'all for a very thoughtfully and thoroughly prepared case, and also I appreciate the thoroughness of your oral argument.

The Court finds upon evaluation that the United States Constitution under the supremacy clause requires this Court to interpret 31 USCA 742 passed in 1976, and to interpret that that statute and the Tennessee Code Annotated 67-751 statute are in conflict, the Court specifically finding that the exceptions under the federal statute have not been met by the state statute. The state statute, therefore, must be declared unconstitutional under the Federal Constitution.

As to its application as to those stocks, bonds, treasury notes and other obligations of the United States as enumerated in the federal statute, the Court specifically finds that that does not invalidate the Tennessee statute for purposes of application for other intangible personal property, and, therefore, does not invalidate the statute completely.

The Court would point out that the statutes involved in this Court's opinion are clear and unambiguous. Therefore, the Court does not deem it appropriate to look at legislative intent. The Court deems it appropriate to look at legislative intent when the Court finds that the reading of a statute is unclear to the Court or is ambiguous or given its normal interpretation cannot be construed in a sensible manner by the Court. And, this Court has not had that difficulty in reviewing these statutes, and the purpose for that limitation in this Court's opinion is that the judiciary should not continuously be running to look at legislative intent on everything that the legislature does, except on those things where the Court has to, to try to figure out what do they mean.

This Court finds that the legislature passed a very clear statute and that it is in conflict with the federal statute, and, therefore, based on what the Court has already reiterated, the plaintiff's motion for summary judgment must be granted and costs be assessed against the defendant. Are there any questions?

MR. TAIT: Would Your Honor rule on our counterclaim for revival of the prior act?

THE COURT: I do not find that that would be appropriate based on what I indicated. I don't find that the statute is unconstitutional to the extent that it invalidates the entire statute, and, therefore, that relief would have to be denied. Are there any other questions?

MR. TAIT: If Your Honor please, one other question. Is Your Honor ruling that only, that the agencies of the United States are exempt or any instrumentalities of the United States?

MR. SCRUGGS: Your Honor, I would point out that you have referred purely to the exemption statute, and in our brief, as well as in the pleadings, we have picked up the various statutes also granting the same exemption by the agencies.

THE COURT: The Court's ruling only as to that one specific statute under the federal law. Any other questions?

MR. TAIT: Your Honor, I'm not clear. I just want to be sure I understand Your Honor's ruling. Is the Court ruling that the only exempt income is from stocks, bonds, treasury notes and other obligations of the United States as set forth in Section 742?

THE COURT: Yes, sir.

MR. TAIT: All right, sir.

MR. SCRUGGS: Well, now, Your Honor, you see in my complaint I have not only alleged the federal exemption statute but also the other federal statutes in regard to the federal land banks, the federal intermediate credit and the banks for cooperatives, which by federal statute are also exempt. Now, they have enabling federal statutes that also exempt them. I believe if you grant my summary judgment, you would be granting the exclusion of all these.

THE COURT: Well, gentlemen, the obligations as I see them, and those enumerated (a) through (e) on page 3 of the plaintiff's memorandum are the ones which I am granting relief on.

MR. SCRUGGS: All right, Your Honor.

THE COURT: And, those are — excuse me, they are not all specifically. I beg your pardon, they are not all specifically in USCA 742.

MR. SCRUGGS: Right, Your Honor. You see each of — (c), (d), and (e) are then covered by the other exemption statutes which I have cited to Your Honor.

MR. TAIT: Your Honor, one of our positions in this case was that if he was entitled to any exemption, it would only be as set forth in 31-742, which says obligations of the United States. Now, these matters that he has got in his brief are technically not obligations of the United States.

MR. SCRUGGS: Your Honor, if you will look at page 9 of my brief, you will see those other statutes, and in essence what those statutes say are that these agencies are in essence carrying out the duties and the obligations of the government, and, therefore, are extended the same exemption privilege as obligations of the United States, which I would say that they are obligations, and I think those statutes are just as clear and precise.

MR. PEEL: Your Honor, I think there is a factual problem too on the other instrumentalities question that the plaintiff doesn't have in the record.

THE COURT: I thought y'all had a stipulation of fact.

MR. SCRUGGS: We do, Your Honor.

MR. PEEL: This is a subject of which I'm not quite clear the status of it, but there was something to be worked out last week. This is a tangential issue.

MR. SCRUGGS: Your Honor —

THE COURT: (Interposing) One at a time. Let him get it all out.

MR. PEEL: The point that I understood previously was that in order for these things to even be deemed an instrumentality of the United States, the shares had to be owned by the government or the farm credit service; is that correct?

MS. WEDDINGTON: One of them.

MR. PEEL: One of these instrumentalities, so we haven't really discussed this poin' this morning thoroughly enough to give Your Honor a basis on which to rule on it. It seems to me there is a factual

problem that the plaintiff has not established that the shares of — which one is it — are actually owned by the governor of the farm credit service.

MR. SCRUGGS: Your Honor, if I might address the Court on this point, we have stipulated, the parties have stipulated that these are the various types of securities that are the subject of this lawsuit.

Your Honor, I have pled in my complaint, and we have also briefed the issue, as well as the defendants have briefed the response, that these obligations of these certain instrumentalities of the United States should or should not be granted the exemption, but it is clearly an issue before you, and those statutes recognize that these instrumentalities are granted the same exemptions as other obligations of the United States.

MR PEEL: In 12 USC, Section 1234 —

THE COURT: (Interposing) 2134.

MR PEEL: 2134, I'm sorry, says the exemption provided in the preceding sentence shall apply only for the year or any part thereof in which the stock in the bank or cooperative is held by the governor of the farm credit service, so that fact is something established in the record. I think before the Court really makes an accurate ruling on that point, that would have to be in the record.

THE COURT: What about with regard to 12 USC 2079?

MS. WEDDINGTON: Your Honor, may I respond to the question of the farm credit system banks?

THE COURT: Before you do, let him respond. There are two other sections.

MS. WEDDINGTON: 2079 and 2055.

THE COURT: Go ahead.

MS. WEDDINGTON: If I may interject myself at this point, and I would first ask a question of the Court. Is Your Honor saying that the 1959 amendment is what has brought about the result of your holding under 742?

THE COURT: Before I respond to that —

MS. WEDDINGTON: (Interposing) Because that is not in —

THE COURT: (Interposing) Y'all have told the Court that y'all have a stipulation of fact. Now, I find after I rendered a ruling, suddenly the stipulation of fact starts disintegrating, so I just want to find out where we stand.

MS. WEDDINGTON: Yes, there is a stipulation of fact. However, in that stipulation the plaintiff would have the burden of putting into the record any fact upon which it wishes to rely. If Your honor is saying that the 1959 amendment has changed the law, and, therefore, 742 precludes the Tennessee statute, Your Honor will also note the language of the 1959 amendment is not included in these exemption statutes for the federal farm credit system banks.

Therefore, since that language is not here, and since these statutes were enacted after the 1959 amendment in 1971, the implication would be that Congress intended to preserve the exemption for bank shares.

THE COURT: Now, the three statutes that y'all have referred to here, 2134, 2079 and 2055, according to what's been submitted to the Court, those have been amended as of 1980; is that not correct?

MS. WEDDINGTON: If Your Honor please, there was a reference to Supp. 1980, which that is something the codification in the big book had not been put together. The language is the same.

If Your Honor will let me, I will go to the library and bring the Code out. It has now been bound in the full volume, and it is a 1980 volume of the 1971 Act.

THE COURT: Well, I still don't see what that has to do with anything, but thank you for telling me about that. Anything else?

MR. SCRUGGS: Yes, Your Honor. This point has been addressed thoroughly in the briefs. If you will remember, Your Honor, in the responsive pleading filed by the defendants, they brought up the issues of the farm, the federal farm credit system, and in my brief, which was filed yesterday, the second issue is Congress properly exercised its authority in the United States Constitution in estab-

lishing federal land banks, banks for cooperatives, and federal intermediate credit banks in exempting the obligations of these banks from state taxation, and then, Your Honor, we cited to you the Smith case and all the history that gives Congress the power to exempt the obligations of these agencies and instrumentalities, but, Your Honor, the point is that the federal exemption statute would cover the treasury obligations and the treasury notes and the T-bills.

Then the exemption statutes contained for each of these agencies clearly states that the income therefrom shall be exempt from all federal, state, municipal and local taxation, just as clear and succinct as the other statute, but those statutes, all four statutes are relied on by the defendant — I mean the plaintiff because of their applicability to the various types of obligations.

THE COURT: The Court adopts as part of its opinion in this matter that the Sections 2134, 2079 and 2055, which again they very clearly say, you know, shall be exempt from all federal, state, municipal and local taxation other than federal income tax liability.

I agree that those under the supremacy clause take precedent over the state statute. It's a burden on the plaintiff, whenever the tax man comes around, to show that these fall underneath here.

The Court finds that the record is still complete based on the stipulation of fact that's written into the record that the Court finds that there is no necessity for any proof since there is no material proof in dispute, the only dispute being that if they claim a certain issue not to be, excuse me, to be under the federal, one of the federal statutes, that is a fact dispute that's not relevant to the ruling by this Court, and that is that if it is and does fall under one of these four federal statutes, that it would be exempt under the tax by the state that is part, the taxation statute of 67-751.

Now, are there any questions remaining?

MR. TAIT: I have nothing else.

THE COURT: Thank you very much, gentlemen and ma'am.

* * * * *

CERTIFICATE

STATE OF TENNESSEE
COUNTY OF SHELBY

I, BRENDA F. RICHBERGER, CSR, RPR, a Notary Public in and for the said State and County, do hereby certify that the foregoing is a transcript of the proceedings in the above-styled cause in the Chancery Court of Shelby County, Tennessee, and that I did report in Stenograph and take down verbatim the proceedings in said cause, and the foregoing pages, 1 through 14, inclusive, constitute a true and correct transcript of the proceedings of said cause.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal this 22nd day of December, 1980.

/s/ BRENDA F. RICHBERGER, CSR, RPR
Notary Public at Large

My Commission Expires:
December 27, 1981.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK AND TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

Defendants.

Order On Judgment

This cause came on to be heard on December 19, 1980, before the Honorable D. J. Alissandratos, Chancellor of the Chancery Court of Shelby County, Tennessee, Part III; upon the second amended complaint filed by the plaintiff; upon the answer and counter complaint filed by the defendants; upon the answer of the counter defendant; upon the affidavits and the stipulation of facts filed by the parties; upon motions for summary judgment; upon the statements of counsel for the plaintiff and counsel for the defendants; and upon the entire record in the cause; and

IT APPEARS to the Court and the Court finds that the plaintiff's motion for summary judgment should be granted and that the defendants' motion for summary judgment should be denied, for the reasons set forth in the oral opinion of the Court which is incorporated by reference and made a part of the record herein, and that plaintiff should have and recover a judgment against the defendant in the amount hereafter set forth.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED:

1. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Riley C. Garner, Shelby County Trustee, in the amount of Fifteen Thousand Two

Hundred Nineteen and 13/100 ($15,219.13) Dollars plus legal interest thereon from January 11, 1979, to the date of entry of this judgment.

2. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Riley C. Garner, Shelby County Trustee, in the amount of Fourteen Thousand Two Hundred Sixty Three and 21/100 ($14,263.21) Dollars plus legal interest thereon from January 8, 1979, to the date of entry of this judgment.

3. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, in the amount of Fourteen Thousand Forty Eight and 43/100 ($14,048.43) Dollars plus legal interest thereon from January 4, 1979, to the date of entry of this judgment.

4. That plaintiff, Memphis Bank & Trust Company, be and is hereby awarded a judgment against the defendant, Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, in the amount of Thirteen Thousand One Hundred Sixty Six and 04/100 ($13,166.04) Dollars plus legal interest thereon from January 4, 1979, to the date of entry of this judgment.

5. That this judgment be and the same is hereby stayed pending appeal.

6. That costs are assessed against the defendants.

/s/ D. J. ALISSANDRATOS
Chancellor

Date: 1/9/81

APPROVED:

/s/ J. MINOR TAIT, JR.,
J. Minor Tait, Jr., Assistant
County Attorney, Attorney for
Defendant, Riley C. Garner,
Shelby County Trustee

/s/ WILLIAM C. BATEMAN by J. M. T.
William C. Bateman, Attorney
for Defendant, Glenn E. Foster,
Treasurer of the City of Memphis,
Tennessee

/s/ JOE C. PEEL by Mary M. Weddington
Joe C. Peel, Assistant Attorney
General intervening on behalf
of Defendants

CERTIFICATE OF SERVICE

I, J. Minor Tait, Jr., certify that a copy of the foregoing order was hand delivered to attorney for plaintiff, Mr. David C. Scruggs, 900 Memphis Bank Building, Memphis, Tennessee 38103, this 9th day of January, 1981.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.

IN THE CHANCERY COURT OF SHELBY COUNTY, TENNESSEE

No. 85780-3

MEMPHIS BANK & TRUST COMPANY,

Plaintiff,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE and GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

Defendants,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE

Intervening Defendant.

NOTICE OF APPEAL

Notice is hereby given that Riley C. Garner, Shelby County Trustee, and Glenn E. Foster, Treasurer of the City of Memphis, Tennessee, and William M. Leech, Jr. Attorney General for the State of Tennessee, the Defendants and Intervening Defendant above named, hereby appeal to the Supreme Court of Tennessee from the final judgment entered in this cause of January 9, 1981.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.
Assistant County Attorney

/s/ MARY MARGARET WEDDINGTON
Mary Margaret Weddington
Attorneys for Defendant,
Riley C. Garner, Shelby
County Trustee
150 East Court Avenue
P.O. Box 3160
Memphis, Tennessee 38103
901-526-0606

/s/ WILLIAM C. BATEMAN, JR. by J.M.T.
William C. Bateman, Jr.
Attorney for Defendant,
Glenn E. Foster, Treasurer
of the City of Memphis,
Tennessee
Suite 1100,
One Commerce Square
Memphis, Tennessee 38103
901-526-0412

/s/ JOE C. PEEL by J.M.T.
Joe C. Peel
Attorney for Intervening
Defendant, William C.
Leech, Jr., Attorney General
for the State of Tennessee
450 James Robertson Parkway
Nashville, Tennessee 37219
615-741-3491

PROOF AND CERTIFICATION OF SERVICE

I, J. Minor Tait, Jr., certify pursuant to Rule 20(e) of the Tennessee Rules of Appellate Procedure that this Notice of Appeal was filed in the Chancery Court of Shelby County, Tennessee, on January 28, 1981, and that a copy of said Notice was served on Mr. David C. Scruggs, Attorney for Plaintiff, Memphis Bank & Trust Company, Suite 900, Memphis Bank Building, Memphis, Tennessee 38103, and on the Clerk of the Supreme Court sitting at Jackson, Tennessee, via U.S. mail, postage, pre-paid, this 28th day of January, 1981.

/s/ J. MINOR TAIT, JR.
J. Minor Tait, Jr.

IN THE SUPREME COURT OF TENNESSEE
AT JACKSON

MEMPHIS BANK AND TRUST COMPANY,
Plaintiff-Appellee,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

and

WILLIAM M. LEECH, JR.,
Attorney General for the State of Tennessee,
Defendants-Appellants.

SHELBY EQUITY

REVERSED AND DISMISSED;
REMANDED FOR COSTS

JUDGMENT
FILED
November 30, 1981

This cause coming on to be heard upon a transcript of the record from the Chancery Court of Shelby County, briefs of Appellants, briefs of Appellee, and argument of counsel, upon consideration whereof the Court is of opinion that in the judgment of the Court below there is reversible error.

In accordance with the opinion of the Court filed herein, it is, therefore, ordered and adjudged by this Court that the judgment of the Court below be reversed and the suit dismissed, and the cause be remanded to the Chancery Court of Shelby County for the collection of the costs of the Court below, for all of which let procedendo issue.

Costs incident to this appeal are taxed to the appellee, Memphis Bank & Trust Company, for which execution may issue if necessary.

11/30/81

IN THE SUPREME COURT OF TENNESSEE
AT JACKSON

MEMPHIS BANK AND TRUST COMPANY,
Plaintiff-Appellee,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

and

WILLIAM M. LEECH, JR.,
Attorney General for the State of Tennessee,
Defendants-Appellants.

SHELBY EQUITY

Hon. D. J. Alissandratos, Chancellor.

For Plaintiff-Appellee:
DAVID C. SCRUGGS
ANDREW H. RAINES
Memphis, Tennessee

For Defendants-Appellants:
J. MINOR TAIT, JR.
Assistant County Attorney
Memphis, Tennessee

MARY MARGARET WEDDINGTON
Memphis, Tennessee

WILLIAM C. BATEMAN, JR.
Assistant County Attorney
Memphis, Tennessee

JOE C. PEEL
Assistant Attorney General
Nashville, Tennessee

Of Counsel:
WILLIAM M. LEECH, JR.
Attorney General
Nashville, Tennessee

Opinion

**REVERSED AND DISMISSED;
REMANDED FOR COSTS.**

HARBISON, C.J.

Appellee paid under protest and sought recovery of the local bank excise tax for the years 1977 and 1978. It contended that the taxing statute was unconstitutional and unenforceable insofar as it required inclusion of interest on federal obligations in measuring the tax. The Chancellor allowed recovery, holding that the state statute was contrary to federal exemption statutes, such as 31 U.S.C. § 742, and to the Supremacy Clause of the United States Constitution. [1] Finding no such conflict, we reverse and dismiss the action.

The decision of the Chancellor was rendered before release of the opinion of this Court in *Commerce Union Bank of Chattanooga* v. *State Board of Equalization*, 615 S.W.2d 151 (Tenn. 1981). He apparently construed the statutes in question, T.C.A. §§ 67-751 to 763, as imposing a tax upon intangible property held by state banks. To the extent that such assets consisted of federal obligations, he found that controlling federal statutes required exemption of these obligations and interest thereon. Although he did not hold the taxing statute unconstitutional in its entirety, the effect of exempting income from federal obligations was to relieve the taxpayer entirely from the subject taxes for the two years in question.

In the case of *Commerce Union Bank of Chattanooga* v. *State Board of Equalization*, *supra*, this Court held that the bank tax enacted in 1977 is not a property tax but is purely an excise tax based upon net earnings as computed under the general corporate excise tax law of the state, T.C.A. §§ 67-2701 to 2732.

The general excise tax is levied upon net earnings "defined as federal taxable income" subject to certain deductions and exemptions. T.C.A. § 67-2704. It has long been held in this state that the general corporate excise and franchise taxes are not property taxes but are taxes laid upon the privilege of doing business in corporate form

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[1] U.S. Const. art. VI, § 2.

and of exercising the corporate franchise in this state. In *American Bemberg Corp.* v. *Carson*, 188 Tenn. 263, 272, 219 S.W.2d 169, 173 (1949), the Court said:

> ". . . the excise and franchise taxes exacted for the privilege of exercising their corporate franchises and doing business in Tennessee, represent a single coordinate scheme of taxation and are to be considered together in determining their burden on complainants and the effect on their constitutional rights."

The constitutionality of the state franchise tax was upheld in the case of *Corn* v. *Fort*, 170 Tenn. 377, 95 S.W.2d 620 (1936), and that of the excise tax in *Bank of Commerce & Trust Co.* v. *Senter*, 149 Tenn. 569, 260 S.W. 144 (1923).

The present state franchise and excise taxes were enacted in 1976. Their predecessors, however, were enacted much earlier and were subjected to the same general attack as is made by the taxpayer in the present case. In *General Securities Co.* v. *Williams*, 161 Tenn. 50, 29 S.W.2d 662 (1930), the 1923 corporate excise tax was challenged because in its measure there was no exclusion of income from federal obligations. While the Court found that the record failed adequately to present the issue, nevertheless it stated:

> "In any event, however, we are unable to see that chapter 21 of the Acts of 1923 is invalid for the reasons urged. We are referred to the case of MacAllen Company v. Massachusetts, 279 U.S., 620, 73 L. Ed., 875. This case is exceptional in its facts. The State of Massachusetts formerly exempted the income from securities of the class here in consideration from the earnings of corporations by which an excise tax was measured. By amendment to previous legislation, the State of Massachusetts deliberately declared that the income from such securities should be included in the aggregate of corporate earnings measuring the excise tax. The amendatory legislation was stricken down because, as the court said, it was 'adopted, as though it had been so declared in precise words, for the very purpose of subjecting these securities *pro tanto* to the burden of the tax.'
>
> "We do not understand that the court overruled *Flint* v. *Stone Tracy Company*, 220 U.S., 107, 55 L. Ed., 389. That case and preceding cases held that a tax lawfully imposed upon the exercise of corporate privileges within the taxing power might

be measured by income from the property of the corporation although a part of such income was derived from non-taxable property. Chapter 21 of the Acts of 1923 was not aimed at the income from non-taxable securities and any resulting burden thereby was fortuitous and incidental." 161 Tenn. at 54, 29 S.W.2d at 663.

In the case of *National Life & Accident Insurance Co.* v. *Dempster*, 168 Tenn. 446, 79 S.W.2d 564 (1935), the Court expressly held that inclusion of interest from federal obligations in computing the corporate excise tax did not invalidate the tax or the statute imposing it. The Court said:

> "The tax imposed by the act is a privilege tax and not a direct tax on property. *Bank of Commerce & Trust Co.* v. *Senter*, 149 Tenn., 569, 260 S.W., 144. The rule seems to be settled that an excise tax statute is not unconstitutional solely because there is included in the income of the taxpayer, by which the tax is measured, interest from tax-free bonds, when such inclusion is incidental and fortuitous.. . .

"The legislation here under consideration discloses only that the state of Tennessee has sought, in good faith, to conform its scheme of taxation of corporations to a permitted method. By the act in question it has adopted a form of privilege tax on corporations measured by their net income, without any form of discrimination as to the sources of the income included in the measure, differing in this respect in no material way, from a similar tax upheld in *Flint* v. *Stone Tracy Co.*, 220 U.S., 107, 31 S. Ct., 342, 55 L. Ed., 389, Ann. Cas. 1912B, 1312, and in *Educational Films Corp.* v. *Ward*, 282 U.S., 379, 51 S. Ct., 170, 75 L. Ed., 100, 71 A.L.R., 1226." 168 Tenn. at 454-55, 79 S.W.2d at 567.

In *Nashville Trust Company* v. *Evans*, 195 Tenn. 205, 258 S.W.2d 761 (1953), the Court held that neither the corporate franchise tax nor the corporate excise tax was a tax upon obligations of the United States or of the income therefrom but that both were non-discriminatory privilege taxes imposed upon all commercial corporations doing business in the state and imposed upon the privilege of engaging in business in corporate form. The predecessor to the present federal exemption statute, 31 U.S.C. § 742, was considered

in that case and held not to invalidate in any respect the state franchise and excise tax statutes.

It therefore appears that most of the issues raised by appellee in the present case have been previously considered. When the tax in question is viewed as an excise tax, as this Court has held that it must be, it becomes clear that many of the issues raised by the taxpayer have been settled contrary to its contentions by both state and federal courts.

The federal exemption statute, 31 U.S.C. § 742, was amended in 1959 and the second sentence quoted below was added:

> "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or Municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

In our opinion, the exception contained in the last part of the second sentence is clearly applicable to the excise tax here under consideration. The tax is not discriminatory in the sense used in the federal statutes. It does not single out federal obligations or the interest therefrom or in any other way treat them as special or direct objects of taxation as occurred in *Miller* v. *City of Milwaukee*, 272 U.S. 713 (1927), or *MacAllen Company* v. *Massachusetts*, 279 U.S. 620 (1929). The present tax is clearly a "nonproperty" tax and is a corporate privilege tax. We do not find persuasive the taxpayer's argument that the term "franchise" tax used in the federal statute excludes a general corporate "excise" tax. As noted previously, in this state, the two terms have frequently been used interchangeably as both being taxes upon the exercise of a corporate franchise within the state. It is well established that a corporate franchise created by a state can legitimately be taxed and that the tax may be imposed without any deduction for federal securities or interest thereon. *Werner Machine Company* v. *Director of Division of Taxation*, 350 U.S. 492 (1956); *Tradesmens National Bank of Oklahoma City* v. *Oklahoma Tax*

Commission, 309 U.S. 560 (1940); *Pacific Company* v. *Johnson*, 285 U.S. 480 (1932); *Educational Films Corp. of America* v. *Ward*, 282 U.S. 379 (1931); *Flint* v. *Stone Tracy Company*, 220 U.S. 107 (1911). In these and many other cases the terms "franchise" and "excise" tax are used interchangeably. We are of the opinion that the local bank excise tax here under consideration is the kind of tax referred to in the federal exemption statute.

We likewise find unpersuasive the contention of the taxpayer that the present tax is "discriminatory" because it is levied only upon banks. The history of the statute is well developed in the record in the present case. As stated in the statute itself, it is in lieu of a tax upon intangible personal property of banks, and it is a successor to a former tax upon shares of banking institutions.

It is well settled that banking institutions are accorded privileges and rights not granted to other commercial corporations and that they therefore may be classified separately by the General Assembly for purposes of taxation and regulation. *Bank of Commerce & Trust Co.* v. *Senter*, 149 Tenn. 569, 587-88, 260 S.W. 144, 149 (1923).

We find nothing in either the general exemption statute relied upon by appellee, 31 U.S.C. § 742, or the particular exemption statutes pertaining to certain types of obligations, 12 U.S.C. §§ 2055, 2079 and 2134, or in the federal constitution which prohibits the measure of the bank excise tax by its federal taxable income, including interest on federal obligations. One of the cases principally relied upon by appellee, *Montana Bankers Association* v. *Montana Department of Revenue*, 580 P.2d 909 (Mont. 1978), involved a direct property tax upon shares of stock in banking corporations. The tax under consideration there was not in any sense an excise or privilege tax upon the exercise of a corporate franchise such as that involved in the instant case. Likewise the case of *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981), appears to have involved a general income or gross receipts tax, and the Court stated that the tax clearly was "not a franchise tax." 429 A.2d at 449.

The judgment of the trial court is reversed and the suit is dismissed at the cost of appellee. The cause will be remanded to the trial court for collection of costs accrued there.

/s/ WILLIAM J. HARBISON
William J. Harbison, C. J.

Fones, Cooper, Brock and Drowota, JJ., concur.

IN THE SUPREME COURT OF TENNESSEE

Shelby Equity No. 6

MEMPHIS BANK AND TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, Shelby County Trustee, and
GLENN E. FOSTER, Treasurer of
the City of Memphis, Tennessee,

Appellees,

and

WILLIAM M. LEECH, JR.,
Attorney General for the State of Tennessee,

Intervening Appellee.

Notice Of Appeal To The
Supreme Court Of The United States
(Date Filed: February 5, 1982)

NOTICE is hereby given that MEMPHIS BANK & TRUST COMPANY, the Appellant above-named, hereby appeals to the Supreme Court of the United States from the Final Judgment of the Supreme Court of the State of Tennessee, entered in this action on November 30, 1981.

The Supreme Court of Tennessee construed the Tennessee Bank Tax of sections 67-751 to 67-763 as a local bank excise tax in lieu of an intangible personal property tax. The Court held that the measure of this Bank Tax by federal taxable income, including the interest on federal obligations, did not violate the Federal Exemption Statute, 31 U.S.C. § 742 (1976), or the specific Federal Agency Exemption Statutes, 12 U.S.C. § 2055 (1976), 12 U.S.C. § 2079 (1976), 12 U.S.C. § 2134 (1976), which forbid state and local authorities from taxing federal obligations. The Court held the Bank Tax was not discriminatory on the basis that it was levied only on banks nor on the basis that the computational base of the tax exempts state obligations from taxation but includes federal obligations and the interest thereon

as taxable. The Court concluded that this local bank excise tax fell within the exceptions to the Federal Exemption Statute, 31 U.S.C. § 742 (1976), for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations.. . ."

The Appellant hereby appeals to the Supreme Court of the United States the judgment of the Supreme Court of Tennessee which reversed the judgment of the Chancery Court of Shelby County and remanded the cause for costs and which sustained the validity of the Bank Tax against Appellant's challenge that the inclusion of interest on federal obligations in the computational base of the tax violated federal law.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, David C. Scruggs, do hereby certify that a copy of the foregoing Notice of Appeal to the Supreme Court of the United States has been served on Appellees by forwarding a copy thereof to:

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via U.S. mail, postage prepaid, this the 4th day of February, 1982.

/s/ DAVID C. SCRUGGS
David C. Scruggs

Supreme Court of the United States

No. 81-1613

MEMPHIS BANK & TRUST COMPANY, *Appellant*,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE, *et al.*

APPEAL from the Supreme Court of Tennessee, Western Division.

The statement of jurisdiction in this case having been submitted and considered by the Court, in this case probable jurisdiction is noted.

April 26, 1982

Motion to Dismiss or Affirm

1

Supreme Court, U.S.
FILED
MAR 29 1982
ALEXANDER L. STEVAS
CLERK

No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

MEMPHIS BANK & TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE,

Appellees.

On Appeal From The Supreme Court Of Tennessee

MOTION TO DISMISS OR AFFIRM

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PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D.C.

COUNTER-STATEMENT OF QUESTION PRESENTED

Whether the state court correctly held that there is no conflict between the local excise tax imposed upon banks doing business in Tennessee, *Tenn. Code Ann.* § 67-751, and the federal statutes exempting obligations of the United States from certain forms of state taxation, 31 U.S.C. § 742, 12 U.S.C. §§ 2055, 2079, and 2134.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-1613

MEMPHIS BANK & TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE,

Appellees.

On Appeal From The Supreme Court Of Tennessee

MOTION TO DISMISS OR AFFIRM

COME NOW the Appellees, Riley C. Garner and Glenn E. Foster, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, and respectfully move that this Court dismiss the appeal, or, in the alternative, affirm the judgment below, on the grounds that it does not present a substantial federal question, the decision of the state court is in accord with applicable decisions of this Court, and there are no special or important reasons warranting briefs on the merits and oral arguments.

OPINION BELOW

The opinion of the Supreme Court of Tennessee, filed November 30, 1981, is reported at 624 S.W.2d 551 (Tenn. 1981), and is reproduced in the Appendix to the Jurisdictional Statement, pp. 3a-9a.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The statement of constitutional and statutory provisions involved contained in the Jurisdictional Statement is adequate.

COUNTER-STATEMENT OF THE CASE

Dissatisfied with the Appellant's statement of the case, these Appellees offer the following counter-statement:

Appellant Memphis Bank & Trust Company [hereinafter, the Bank] is a state chartered corporation with principal offices in Memphis, Shelby County, Tennessee. Appellees Riley C. Garner, Shelby County Trustee, and Glenn E. Foster, Treasurer of the City of Memphis, are local governmental officers charged with the responsibility of collecting certain state and local taxes.

The Bank paid under protest the 1977 and 1978 local excise taxes imposed on each bank doing business in Tennessee by *Tenn. Code Ann.* § 67-751, and thereafter filed suit in the Chancery Court of Shelby County, Tennessee, for recovery of the taxes, contending in its amended complaint that the bank tax was impermissibly levied upon obligations of the United States in violation of the federal exemption statutes, 31 U.S.C. § 742, 12 U.S.C. §§ 2055, 2079, and 2134.

The challenged state statute requires each bank doing business in the state to pay to local governments "an excise tax of three percent (3%) of the net earnings for the next preceeding fiscal year" less specified deductions. The statute provides that

"net earnings" are to be calculated using the formula defined in the general corporate excise tax, *Tenn. Code Ann.* § 67-2704, which is reproduced in the Appendix to the Jurisdictional Statement, pp. 42a-43a. "Net earnings" are defined as "federal taxable income" subject to certain federal deductions and enumerated adjustments. Although the statutory definition of "net earnings" makes no reference whatsoever to United States obligations, the interest which the Bank receives on its investment in federal securities is included in the initial determination of "federal taxable income."

In answer to the Bank's complaint, Appellees contended that the incidental and fortuitous inclusion of federal obligation interest in the formulation of "net earnings" was permissible under a long line of decisions of this Court and under the express language of 31 U.S.C. § 742 excepting nondiscriminatory franchise taxes from the prohibition of the exemption statute. Contrary to the Bank's assertion, these Appellees have never conceded nor stipulated that the Tennessee bank tax is anything other than a local excise tax.

Upon motions for summary judgment on behalf of all parties, the trial court held that the state tax conflicted with federal law to the extent that interest from federal securities was included in"federal taxable income" and, thus, included in the computation of "net earnings." Judgment was entered in favor of the Bank, and Appellees filed notices of appeal to the Supreme Court of Tennessee.

Shortly thereafter, in an unrelated case concerning the applicable fiscal year to be used in measuring the bank tax, the Supreme Court of Tennessee held that the tax was an additional corporate excise tax payable to local governments and must be so regarded and administered. *Commerce Union Bank of Chattanooga* v. *State Board of Equalization*, 615 S.W.2d 151 (Tenn. 1981).

In reversing the ruling of the chancellor in the instant case, the Supreme Court of Tennessee unanimously held that there was no conflict between the federal exemption statutes and the bank tax, which is "a corporate privilege tax." In so holding, the state tribunal relied upon the well established decisions of this Court consistently upholding franchise taxes measured by a yard-stick which includes tax exempt income, even though a part of the economic impact of the tax may be said to bear indirectly upon such income.

REASONS FOR DISMISSING THE APPEAL OR, IN THE ALTERNATIVE, AFFIRMING THE JUDGMENT BELOW

The question presented in this appeal as to the constitutionality of the Tennessee local excise tax on banks is not substantial because it has previously been determined and foreclosed adversely to Appellant by the numerous applicable prior decisions of this Court.

More than one hundred years ago, this Court decided that, while the obligations of the United States are constitutionally and statutorily immune from state taxation, the authority for the state to tax all manner of privileges, including corporate franchises, is independent of the federal government and wholly unaffected by whether the taxpayer has or has not made investment in federal securities. *Society for Savings* v. *Coite*, 6 Wall. 594, 606 (1867). While this Court has consistently held that the instrumentalities of either the state or the federal government, or the income derived therefrom, may not be the direct object of taxation by the other, this Court has also consistently held that the privilege of exercising the corporate franchise is a proper object of taxation despite the inclusion of the other government's obligations or income in the corporate property or net income by which the tax is measured and despite the indirect effect which the privilege tax may have upon the other government. *Educational Films Corp.* v. *Ward*, 282 U.S. 379, 389 (1931).

There simply are no new or unique circumstances presented in this appeal which would bring the case outside the long standing and well settled rule of this Court affirming the constitutional power of state governments to impose taxes upon privileges such as the corporate franchise regardless of the casual or indirect effect the tax may impose upon federal obligations where they or their income are included in the measure of the tax. *Werner Machine Company* v. *Director of Division of Taxation*, 350 U.S. 492 (1956); *Trademens National Bank of Oklahoma City* v. *Oklahoma Tax Commissioner*, 309 U.S. 560 (1940); *Pacific Co.* v. *Johnson*, 285 U.S. 480 (1932); *Educational Films Corp.* v. *Ward*, *supra*; *Flint* v. *Stone Tracy Co.*, 220 U.S. 107 (1911).

Appellant Bank invokes the specter of depletion of the federal treasury should this Court fail to strike down the Tennessee bank tax. Surely, however, the Tennessee tax poses no new or greater jeopardy to the borrowing power of the United States than did the myriad of state privilege, excise, and franchise taxes which have been validated by this Court for over a century.

The Bank properly concedes that the second sentence of 31 U.S.C. § 742 added to the federal exemption statute by amendment in 1959 was intended only as a clarification of the law as it had existed and had been interpreted by this Court since 1862 and did nothing to broaden the scope of the exemption. Jurisdictional Statement, p. 12, fn. 7. Obviously, then, the question presented on this appeal continues to be controlled by the prior decisions of this Court interpreting the federal exemption statute and upholding state excise and franchise taxes similar to the challenged local excise tax on banks doing business in Tennessee.

In its Jurisdictional Statement, the Appellant attempts to avoid the impact of the applicable decisions of this Court by contending that the Tennessee tax is either an income tax or an

ad valorem tax on personal property. The Bank's contention is clearly contrary to the express language of the Act which provides that "each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceeding fiscal year. . . ." *Tenn. Code Ann.* § 67-751. The Bank complains for the primary reason that the magic words "imposed for the privilege of doing business" do not appear in the statute. However, as this Court has previously noted, ommission of the word "privilege" does not alter the character of the tax; "to strike down a tax . . . because of such verbal ommission would only prove a victory for empty formalism." *City of Detroit* v. *Murry Corporation of America*, 355 U.S. 489, 493 (1957).

Moreover, the Supreme Court of Tennessee has, on independent examination, twice found the Bank tax to be a bona fide corporate privilege tax. *Memphis Bank & Trust Company* v. *Garner*, 624 S.W.2d 551 (Tenn. 1981); *Commerce Union Bank of Chattanooga* v. *State Board of Equalization*, 615 S.W.2d 151 (Tenn. 1981). There is no basis in this instance for not accepting the state court's conclusion that this tax is not imposed directly on the federal interest income received by the corporation.

In an effort to create a substantial question in this case, Appellant asserts that even if the state tax is a bona fide excise or franchise tax, it is unconstitutioal because it is discriminatory. The Bank first contends that discrimination occurs where the tax is levied in addition to other state privilege taxes. However, it is well settled under Tennessee law that, where the legislative intent is clear, more than one privilege or excise tax may be exacted from a particular taxpayer. *Camden Fire Insurance Association* v. *Haston*, 153 Tenn. 675, 284 S.W. 905 (1926). The Bank does pay general excise and franchise taxes to the state commissioner of revenue; the bank tax, on the other hand,

is payable by all corporations engaged in the banking business to local city and county governments, not to the state.

The power of the state to tax privileges is indeed subject to the constitutional limitation that the tax must not be discriminatory, i.e., arbitrary, capricious, or wholly unreasonable. *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522 (1959). The Appellant herein overlooks the unique and powerful status enjoyed by those corporations permitted to engage in the banking business in Tennessee. It is well settled that banking institutions are accorded privileges and rights not granted to other commercial corporations in Tennessee and that they may be classified separately by the state legislature for purposes of taxation and regulation. *Bank of Commerce and Trust Company* v. *Senter*, 149 Tenn. 569, 587-88, 260 S.W. 144, 149 (1923). Because there is no evidence of arbitrary, capricious, or irrational classification in the imposition of the excise tax on banks, there is no prohibited discrimination. Moreover, the Bank's reliance upon *Schuylkill Trust Company* v. *Commonwealth of Pennsylvania*, 296 U.S. 113 (1935), is misplaced and inapplicable because the state statute under consideration there involved a direct property tax, not a tax upon a privilege, excise, or franchise.

In a final effort to elevate the issues presented by this appeal to a level of significance, the Appellant Bank has attempted to create a so-called conflict in recent state court decisions. Jurisdictional Statement, p. 13, fn. 8. A cursory review of those opinions quickly exposes the false conflict. Those opinions from the courts of Georgia, Rhode Island, Texas, and Montana dealt with property taxes, thus involving none of the issues under consideration in the present case. However, the opinion of the Supreme Court of Minnesota in *Reuben L. Anderson-Cherne, Inc.* v. *Commissioner of Taxation*, 226 N.W.2d 611 (Minn. 1975), *appeal dismissed*, 98 S.Ct. 181, which was addressed to the constitutionality of a corporate excise tax

measured by net income, including interest on federal obligations, is wholly consistent with the instant decision of the Supreme Court of Tennessee and with the prior applicable decisions of this Court.

CONCLUSION

This appeal raises no new, important, or nationally significant federal question. The decision of the Supreme Court of Tennessee upholding the local excise tax upon banks doing business in Tennessee is entirely consistent with numerous prior decisions of this Court. For these reasons, Appelless respectfully move that this appeal be dismissed, or, alternatively, that the judgment of the state court be affirmed, as there is no substantial question presented.

Respectfully submitted,

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Motion to Dismiss or Affirm

2

Supreme Court, U.S.
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No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,
Appellees.

On Appeal From The Supreme Court Of Tennessee

MOTION TO DISMISS OR AFFIRM

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COUNTER-STATEMENT OF QUESTION PRESENTED

Whether the state court correctly held that 31 U.S.C. §742 and 12 U.S.C. §§2055, 2079 and 2134 do not prohibit the imposition of a local excise tax levied on banks doing business in Tennessee when the measure of said bank tax is federal taxable income which incidentally includes, among other items of income, interest on federal obligations and interest on the obligations of federal agencies.

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No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,
Appellees.

On Appeal From The Supreme Court Of Tennessee

MOTION TO DISMISS OR AFFIRM

The Appellee, William M. Leech, Jr., Attorney General for the State of Tennessee, moves the Court pursuant to Rule 16 to dismiss the appeal herein, or in the alternative, to affirm the judgment of the Supreme Court of Tennessee. The appeal presents no substantial federal question which has not been previously decided by this Court.

OPINION BELOW

The opinion of the Supreme Court of Tennessee, filed November 30, 1981, is reported at 624 S.W.2d 551 (Tenn. 1981) and is reproduced in the Appendix to the Jurisdictional Statement, pp. 3a - 9a.

CONSTITUTIONAL AND STATUTORY PROVISION INVOLVED

The statement of the constitutional and statutory provisions involved contained in the Jurisdictional Statement is adequate.

PROCEEDINGS BELOW

On June 27, 1979 the appellant filed its complaint in the Chancery Court for Shelby County, Tennessee to recover bank taxes paid under protest for the tax years 1977 and 1978. The appellant alleged that the Tennessee bank tax (T.C.A. § 67-751 *et seq.*) was computed on the basis of the appellant's "net earnings" which were defined in T.C.A. § 67-2704 as "federal taxable income." Since income from United States obligations is included in federal taxable income, the appellant alleged that the bank tax was in violation of the exemption provision of the Supremacy Clause in the United States Constitution.

In the process of stipulating the amounts in question, it was determined that the interest earnings of the appellant from "United States obligations" also included interest earnings from obligations of federal land banks, federal intermediate credit banks, banks for cooperatives, Federal National Mortgage Association and Farm Home Administration.

Subsequently, the appellant amended its complaint alleging that in addition to being in violation of 31 U.S.C. §742, (statutory exemption for United States Treasury obligations) the Tennessee bank tax was also in violation of 12 U.S.C. §§ 2055, 2079 and 2134, (statutory exemptions for obligations of federal

land banks, federal intermediate credit banks and banks for cooperatives). At this time the appellant reduced its claim with respect to the interest associated with the Federal National Mortgage Association notes and the interest associated with Farmers Home Administration bonds and conceded that those items were not treated as United States obligations. The amended complaint alleged in the alternative that the bank tax was unconsitutional as applied or was unconstitutional under the Supremacy Clause in the United States Constitution.

The Shelby County Chancery Court granted Memphis Bank & Trust's motion for summary judgment and held that the bank tax to the extent that it included "stocks, bonds, treasury notes and other obligations of the United States" was in conflict with 31 U.S.C. §742 and thus unconstitutional as applied. That opinion was dated December 19, 1980.

On the appeal to the Tennessee Supreme Court, the Trial Court decision was reversed and the Tennessee Supreme Court held that the Tennessee bank tax clearly comes within the exception provided in the second sentence of 31 U.S.C. §742 and is not in conflict with the exemption statutes. The Court found that it is well established by prior cases of this Court that a corporate franchise created by the state can legitimately be taxed and that the tax may be imposed without any deduction for federal securities or interest thereon. See 624 S.W.2d at 554. In an independent examination of the bank tax, *Commerce Union Bank of Chattanooga* v. *State Board of Equalization,* 615 S.W.2d 151 (Tenn. 1981), the Court had found that the bank tax was a local excise tax imposed on the exercise of the privilege of doing business in the corporate form. Following well established precedent, the Court also found that the bank tax is nondiscriminatory and is a nonproperty tax. *Memphis Bank & Trust* v. *Garner,* 624 S.W.2d 551, 554 (Tenn. 1981).

ARGUMENT

This Case Presents No Substantial Federal Question Not Previously Decided By This Court.

The decision of the Tennessee Supreme Court holding that the Tennessee bank tax does not infringe upon immunity of federal obligations is based on and in accordance with the prior decisions of this Court on that issue. The Court noted at 624 S.W.2d 554:

> It is well established that a corporate franchise created by a state can legitimately be taxed and that the tax may be imposed without any deduction for federal securities or interest thereon. *Werner Machine Co.* v. *Director of Division of Taxation,* 350 U.S. 492 (1956); *Tradesmens National Bank of Oklahoma City* v. *Oklahoma Tax Commission,* 309 U.S. 560 (1940); *Pacific Company* v. *Johnson,* 285 U.S. 480 (1932); *Educational Films Corp. of America* v. *Ward,* 282 U.S. 379 (1931); *Flint* v. *Stone Tracy Company,* 220 U.S. 107 (1911).

The appellant challenges the Tennessee bank tax by asserting that it violates the doctrine of the immunity of federal obligations as codified in 31 U.S.C. §742. The appellee asserts that this issue has been before this Court on a number of occasions and that this appeal does not raise a substantial federal question which has not been previously decided.

The Tennessee Supreme Court independently determined in *Commerce Union Bank of Chattanooga* v. *State Board of Equalization,* 615 S.W.2d 151 (Tenn. 1981) that the bank tax is a local excise tax imposed on the privilege of doing business in the corporate form and is not a property tax. The measure of the Tennessee bank tax is the same measure as the state excise tax which defines the tax base as "federal taxable income." Thus, the measure of the bank tax incidentally includes federal securities. According to the decisions cited by the Tennessee

Supreme Court as quoted above, the Tennessee bank tax is not in violation of the immunity afforded federal securities.

The appellant's challenge to the Tennessee bank tax relies on the language of the 1959 amendment to 31 U.S.C. §742. This challenge is without merit because the exemption statute is in effect a codification of the doctrine of constitutional immunity of federal obligations which arose in the decision of *Weston* v. *City Council of Charleston,* 27 U.S. 449, 7 L.Ed. 481 (1829) and the subsequent decisions applying that doctrine. Further, as the appellant admits in Footnote 7 in the Jurisdictional Statement, the 1959 amendment was not intended to change the law or overrule the Supreme Court decisions with respect to the constitutional immunity doctrine. Therefore, the appellees submit that the Tennessee Supreme Court, in accordance with the previous decisions of this Court, correctly found that the Tennessee bank tax is not in conflict with 31 U.S.C. §742 and 12 U.S.C. §§2055, 2079 and 2134.

The authority which the appellant relies upon to challenge the Tennessee bank tax does not present a substantive federal question or point to conflicts within the decisional law. To assert that the bank tax is in violation of the federal immunity doctrine, the appellant first relies upon *Schuylkill Trust Co.* v. *Commonwealth of Pennslyvania,* 296 U.S. 113 (1935). The appellee submits that the *Schuylkill Trust* case is totally unrelated to the issue at hand since the tax involved in that case was a direct property tax which is clearly prohibited and has always been prohibited under 31 U.S.C. §742 and the decisions of the United States Supreme Court dating from *Weston* v. *City Council of Charleston.* 27 U.S. 449 (1829).

Also the appellant relies upon *Werner Machine Co.* v. *Director of Div. of Taxation,* 350 U.S. 492 (1956). The appellant cites this case as a test for determining whether a tax is discriminatory. The appellee would point out that *Werner Machine Co.* dealt with a taxpayer's claim that a franchise tax

was a direct tax upon federal obligations under the holding in *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals,* 338 U.S. 665 (1950). The point being made by the Court in the dicta relied on by the appellant herein is that the corporate franchise tax in *Werner Machine Co.* was not a direct tax upon federal obligations. That statement negated the possibility of a finding of a prohibited direct taxation of federal obligations as found in other cases such as *Weston* v. *City Council of Charleston,* above; *Miller* v. *City of Milwaukee,* 272 U.S. 713 (1927) and *MacAllen Co.* v. *Massachusetts,* 279 U.S. 620 (1929). In those cases, this Court held state tax statutes unconstitutional because said statutes singled out federal obligations or the interest thereon and treated them as special or direct objects of taxation. The appellee concludes that the appellant's implied assertion that *Werner Machine Co.* established a new test contrary to the previous decisions is without merit.

The appellee denies that the several states of the United States are in a push to circumvent the federal exemption statute because of the current economic conditions. The appellant attempted to establish this proposition by citing five cases in Footnote 8 on p. 13 of its Jurisdictional Statement.

The appellee asserts that the appellant's argument in this regard is not credible. First, it is noted that three of the cases are bank share tax cases originating from a decision of the Supreme Court of Montana in *Montana Bankers Association* v. *Montana Department of Revenue,* 580 P.2d 909 (Mont. 1978). That case arose from a challenge to a rule adopted by the Montana Department of Revenue and applied to bank share taxes for the year 1976. As a result of a favorable ruling to the banks in that situation, banks in other states filed challenges to bank share taxes, *e.g.,* Georgia [*Bartow County Bank* v. *Bartow City Board of Tax Assessors,* 285 S.E. 2d 920 (Ga. 1982)] and Texas [*Bank of Texas* v. *Childs,* 615 S.W.2d 810 (Tex. Civ. App. 1981)]. The present case before this Court was also inspired by that decision. Those cases did not arise because the states were attempting to

circumvent the federal exemption statute. To the contrary, those cases arose because banks began to assert *almost 20 years after the 1959 amendment* that said amendment was intended to change 31 U.S.C. §742 and intended to set aside the prior Supreme Court decisions on this question. Bank share taxes have been around for a long time and according to the decisions of this Court bank share taxes have been upheld as not violating the constitutional immunity of federal obligations as codified in 31 U.S.C. §742 even though bank share taxes were measured by corporate assets which included federal obligations. *See Van Allen* v. *Assessors,* 70 U.S. (3 Wall.) 573 (1866); *National Bank* v. *Commonwealth,* 76 U.S. (9 Wall.) 353 (1870); *Cleveland Trust Co.* v. *Lander,* 184 U.S. 111 (1902); *Des Moines National Bank* v. *Fairweather,* 262 U.S. 103 (1923); *Home Savings Bank* v. *Des Moines,* 202 U.S. 503 (1906); *Society for Savings* v. *Bowers,* 349 U.S. 143 (1955).

The appellant also cites *Federal Products Corp.* v. *Norberg,* 429 A.2d 447 (R.I. 1981) as an example of a state attempting to circumvent the federal exemption statute. This case involved a general income or gross receipts tax and as the Tennessee Supreme Court observed at 624 S.W.2d 555 the tax was clearly not a franchise tax. According to the doctrine of federal immunity, such a direct tax on the income from federal obligations was prohibited.

Finally, the appellant relies on the case of *Reuben L. Anderson-Cherne, Inc.* v. *Commissioner of Taxation,* 226 N.W. 2d 611 (Minn. 1975) for its assertion that states are attempting to circumvent the federal exemption statute. The taxes in question were for the tax years 1968, 1969 and 1970 and involved a corporate franchise tax which permitted the inclusion of interest income on federal obligations in the computation of the "net income" tax base. The Supreme Court of Minnesota held that this inclusion of interest income on federal obligations in the computation of the measure of the tax did not violate 31 U.S.C. §742.

CONCLUSION

The Tennessee Supreme Court followed the existing precedent and held as the court in *Anderson-Cherne* that a state tax imposed upon the privilege of exercising a corporate franchise does not violate the doctrine of federal immunity, as codified in 31 U.S.C. §742, by the inclusion of federal obligations in the measure of the tax.

In *Anderson-Cherne,* this Court dismissed the appeal of the taxpayer for want of a substantial federal question. 423 U.S. 886, 46 L.Ed. 2d 118, 96 S.Ct. 181.

The appellee submits that there is also a lack of a substantial federal question in this case and that this appeal should likewise be dismissed since the issues presented are sufficiently covered by existing precedent.

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Appellant's Reply Brief

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and

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and

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Appellees.

On Appeal From The Supreme Court Of Tennessee

APPELLANT'S BRIEF IN OPPOSITION TO MOTIONS TO DISMISS OR AFFIRM

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Pursuant to Rule 16.5, appellant submits this Reply to Appellees' Motions to Dismiss or Affirm.[1]

Nothing in these motions diminishes the importance of this case, and plenary review by this Court remains appropriate. Indeed, appellees arguments that this case is unworthy of this Court's review are based on a series of erroneous assumptions.

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[1] Two separate Motions to Dismiss or Affirm have been filed by appellees, one by appellees Garner and Foster, and one by appellee Leech.

Appellees' opposition to this appeal rests initially on the incorrect premise that the bank tax in issue is clearly an excise tax. Garner and Foster's Motion at 6; Leech's Motion at 4. This premise is destroyed by the express language of the bank tax itself, which provides for taxation of "shares of banks and banking associations" as a "*subclassification of intangible personal property*." Tenn. Code Ann. § 67-751, Jurisdictional Statement at 3; emphasis added. Moreover, contrary to the assertion of appellees Garner and Foster (Garner and Foster's Motion at 3), the trial court stipulation of *all* parties refers to the bank tax as an "intangible personal property tax" no fewer than nineteen times. Jurisdictional Statement at 27a-32a. Never once does the stipulation mention or refer to the bank tax as any sort of excise tax whatever. Jurisdictional Statement at 27a-32a.

The second erroneous premise on which appellees arguments are based is that the Tennessee bank tax is a franchise tax. As appellants have shown, this notion is contrary to the operation and effect of the tax. Jurisdictional Statement at 9-10. Appellees' error is particularly clear from an analysis of *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981). The tax involved in *Federal Products Corp.* was the "Rhode Island Business Corporation Tax" which, like the Tennessee bank tax, was measured by income including interest derived from federal securities.[2] Although the Rhode Island tax did not directly tax federal interest, it included that interest, together with proceeds of sale of federal securities, in gross receipts, which formed the basis for allocating in-state and out-of-state income. The court, noting that inclusion of the tax-exempt obligations in the measure of the tax increased the tax assessed by more than $11,000, concluded that the tax was "an indirect tax upon

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[2] Appellees Garner and Foster, attempting to distinguish this case of the Supreme Court of Rhode Island, incorrectly state that it dealt with a property tax. Garner and Foster's Motion at 7.

federal securities and, thus, invalid" under the federal exemption statute. 429 A.2d at 449. As to the franchise tax exception, the court stated:

> "It is clear, however, that the tax in the case at bar was not a franchise tax. The tax was instead levied pursuant to . . . the Business Corporation Tax, and not pursuant to . . . the Corporate Franchise Tax." 429 A.2d at 449-450; citations omitted.

In light of this opinion, it is beyond peradventure that the Tennessee bank tax is no more a franchise tax than the tax at issue in *Federal Products Corp.*

Appellee Leech attempts to distinguish the tax in *Federal Products Corp.* as a direct tax (Leech's Motion at 7), contrary to the specific finding of the court, quoted above, that the tax was an "indirect tax upon federal securities." As *Federal Products Corp.* indicates, classification of the bank tax as a direct or indirect tax is not determinative of its validity under the federal exemption statute. Nevertheless, all three appellees repeatedly attempt to distinguish cases cited by appellant on the ground that they involve direct taxes on federal obligations and frequently refer to the bank tax as an "indirect" tax which "incidentally" includes interest on federal obligations. Garner and Foster's Motion at 3, 4, 5, 6; Leech's Motion at i, 4, 5, 6, 7. However, even if it is assumed that the Tennessee bank tax is properly characterized as being an indirect tax on income from U.S. obligations or as having only an indirect effect on the U.S., appellees' reliance on such a characterization avails them nothing. The federal exemption statute clearly and specifically directs that federal obligations or interest thereon may not "be considered, *directly or indirectly*, in the computation of the tax." 31 U.S.C. § 742, Jurisdictional Statement at 4; emphasis added.

Finally, appellees contend that the Tennessee bank tax is not discriminatory. Appellees Garner and Foster argue that this is

so because the tax rests on a separate classification of banks for purposes of taxation which is not arbitrary, capricious or wholly unreasonable. Garner and Foster's Motion at 7. For this notion they rely on a Tennessee Supreme Court decision, *Bank of Commerce & Trust Co.* v. *Senter*, 260 S.W. 144 (Tenn. 1924), and on this Court's decision in *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522 (1959), a case involving the validity of an ad valorem tax under the equal protection clause of the Fourteenth Amendment. Their argument, however, wholly fails to address the meaning of the term "nondiscriminatory" in the context of the federal exemption statute, and *it completely ignores appellant's contention that the bank tax is discriminatory because it taxes interest on federal obligations while exempting interest on obligations of Tennessee and its subdivisions*. Jurisdictional Statement at 10-11.

Appellees contend that the principles announced in *Schuylkill Trust Co.* v. *Commonwealth of Pennsylvania*, 296 U.S. 113 (1935), as to the meaning of "discriminatory" are inapplicable because that case involved a property tax. Garner and Foster's Motion at 7; Leech's Motion at 5. However, the decision in *Schuylkill* did not depend on any determination of the type of tax involved. As this Court said, "We think that the issue of discrimination is not to be resolved by a choice between the two contentions as to the nature of the tax." 296 U.S. at 120. The decision, holding "discriminatory," and thus invalid, a state tax statute exempting securities of state corporations from the measure of tax while denying such exemption to federal government securities and those issued by federal instrumentalities, is clearly applicable to the tax involved here, irrespective of whether the tax is a direct or indirect tax on property or even considered a tax on something else.

Appellee Leech also attempts (Leech's Motion at 5-6) to minimize the impact of *Werner Machine Co.* v. *Director of*

Division of Tax, 350 U.S. 492 (1956), where, in upholding a state franchise tax, this Court stated:

> "Since [unlike the situation here] the tax remains the same whatever the character of the corporate assets may be, no claim can be sustained that this taxing statute discriminates against the federal obligations." 350 U.S. at 493-494.

Appellee's reference to this quotation as dicta is incorrect, since if the Court had found the tax in *Werner* discriminatory, it would have been invalid. If appellees are correct in their contention that the bank tax is really a franchise tax, such as was involved in *Werner*, the effect of this sentence from that case is inescapable: where the amount of tax payable by the bank varies with changes in the character of a bank's income-producing assets, and income from federal obligations is taxed while income from Tennessee obligations is not, the tax discriminates against federal obligations.

The principles employed in *Schuylkill* and *Werner* have also been applied by the Supreme Court of Pennsylvania in a case strikingly similar to this one. *Commonwealth* v. *Curtis Pub. Co.*, 69 A.2d 410 (Pa. 1949), *cert. denied* 339 U.S. 928 (1950). In *Curtis* the court considered the validity of the Pennsylvania Corporate Net Income Tax Act, as in effect in 1942, which included interest on U.S. securities in "net income" on which the tax was computed but excluded interest on state and municipal securities and dividends from corporate stock. After considering a number of opinions of this Court, including many cited by appellees herein, the court concluded, relying heavily on *Schuylkill*, that inclusion of interest on U.S. obligations in net income resulted in an unconstitutional discrimination against those obligations because obligations of Pennsylvania and its subdivisions still remained untaxed.[3] 69 A.2d at 422.

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[3] Pennsylvania, like Tennessee in the present case, imposed a tax on income as determined for federal tax purposes (with minor adjustments not relevant here), and because income for federal tax purposes included income from federal obligations but excluded income from state obligations, the same distinction applied for purposes of the state tax.

Refusing to distinguish *Schuylkill* on the ground that it involved a property tax, the court observed that because of the potential widespread holding of U.S. obligations by Pennsylvania corporations, the operation of the tax would

> "to a very substantial degree impair the marketability of national securities in Pennsylvania. A discrimination effecting such a result cannot be dismissed as merely 'casual or incidental' . . .
>
> The purpose of the applicable constitutional provisions [the Supremacy Clause and the Borrowing Clause] as enunciated by the Supreme Court is to prevent discrimination against securities of the United States which would be prejudicial to them when they are offered for sale in competition with state and municipal securities. When Pennsylvania *exempts* from taxation its own securities but *taxes*, directly or indirectly, the securities of the *United States* the latter securities are handicapped in their competition with the securities of Pennsylvania, among buyers in the market place. This handicapping is by implication proscribed by the Constitution of the United States." 69 A.2d at 421.

CONCLUSION

For the reasons set forth in the Jurisdictional Statement and in this Brief in Opposition, this Court should note probable jurisdiction of this appeal.

Respectfully submitted.

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QUESTION PRESENTED

Whether the Tennessee bank tax imposed by Section 67-751, *et seq.*, of the Tennessee Code Annotated is in violation of 31 U.S.C. § 742 (which exempts from taxation by state or local authorities interest earned on obligations of the United States) and 12 U.S.C. §§ 2055, 2079 and 2134 (which contain similar exemptions for income from the obligations of federal farm credit instrumentalities) when the amount of the tax is measured by the bank's net earnings, defined to include interest on obligations of the United States and its instrumentalities, there being excluded from such definition interest earned on bonds and other obligations of the State of Tennessee and its political subdivisions, and there being a separate franchise tax and a separate corporate excise tax imposed on all corporations, including banks, for the privilege of doing business in Tennessee.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-1613

MEMPHIS BANK & TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE,

Appellees.

Appeal From The Supreme Court Of Tennessee

BRIEF OF APPELLANT

Appellant, Memphis Bank & Trust Company[1] ("Memphis Bank & Trust") appeals from a final judgment of the Supreme Court of Tennessee, entered November 30, 1981, upholding the validity of a Tennessee statute, Tenn.

[1] Appellant Memphis Bank & Trust is a wholly owned subsidiary of Memphis Trust Company, a holding company. Other subsidiaries of the holding company are Central Guardian Life Insurance, Memphis Trust Insurance Agency, Inc., and Arrow Business Interiors.

Code Ann. § 67-751, *et seq.*, which Memphis Bank & Trust had challenged on the ground that, as applied to it, the statute violates the laws of the United States and is repugnant to the Constitution.

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee, reported at 624 S.W.2d 551 (Tenn. 1981), is reproduced in the Joint Appendix at 75a-81a.

The Order on Judgment entered January 9, 1981, by the Chancery Court of Shelby County, Tennessee, Part III, from which the appeal to the Supreme Court of Tennessee was taken, is not reported, but is reproduced in the Joint Appendix at 69a-71a. That Order On Judgment incorporated by reference the oral opinion of the court rendered December 19, 1980. The transcript of that opinion is reproduced in the Joint Appendix at 61a-68a (hereinafter "J.A. ____").

JURISDICTION

The final judgment of the Supreme Court of Tennessee (J.A. 74a) was entered November 30, 1981. A Jurisdictional Statement was filed on March 1, 1982, within ninety days of the entry of that judgment. The order noting probable jurisdiction was filed on April 26, 1982 (J.A. 85a). On Appellant's motions the time for filing the Joint Appendix and Appellant's brief on the merits was extended to and including July 20, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

United States Constitution, Article VI, Clause 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

United States Constitution, Article I, Section 8, Clause 2

Section 8. The Congress shall have Power . . . To borrow Money on the credit of the United States.

Tennessee Code Annotated

Bank Tax [2]

67-751. Excise tax on bank earnings—Rate.—There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad

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[2] The pertinent provisions of the act of the Tennessee Legislature (1977 Tenn. Pub. Acts, ch. 140), which is codified as Tenn. Code Ann. §§ 67-751 through 67-763 and which contains a lengthy preamble, are set out in the Appendix to this brief, pp. 4a-7a (hereinafter "Appendix, p. ____").

valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject.

67-752. Minimum tax.—In no event shall the tax imposed under § 67-751 upon any bank be less than an ad valorem tax calculated on the basis of sixty percent (60%) of the book value of the bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits.

In determining the value to be assessed, the following shall be deducted from the sixty percent (60%) book value:

(1) The appraised value of all real property and tangible personal property otherwise owned and assessed to companies subject to this tax; and

(2) The appraised value of all real property in Tennessee occupied by companies subject to this tax and used for

the purpose of conducting their business under a lease which provides that all ad valorem taxes on such property shall be paid by such companies and said lease has been registered in the county where such property is located.

The remaining value shall be assessed at forty percent (40%) and the resulting assessment shall be the amount to which the appropriate city and county tax rates shall be applied to determine the tax due and payable to the respective taxing jurisdictions.

67-754. Allocation of tax.—Unless the tax imposed herein shall be calculated under § 67-752, the total tax shall be allocated between the county and municipality where the principal office of the bank is located in the same proportion as the property tax rate of each taxing jurisdiction for the immediately preceding year shall bear to the sum of said property tax rates of both taxing jurisdictions . . .

31 U.S.C. § 742

Exemption From Taxation

Except as otherwise provided by law,[3] all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of

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[3] The phrase "Except as otherwise provided by law" appears in 31 U.S.C. § 742, but does not appear in the official Statutes at Large, Section 3701 of the Revised Statutes of the United States. The phrase was inserted by the Revisers in the 1926 general revision of the Code, and has not been enacted as law. *See* Codification Note to 31 U.S.C. § 742.

the tax, except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

The following statutes are also involved in this case and are set out verbatim in the Appendix, pp. 1a-2a: 12 U.S.C. §§ 2055, 2079, and 2134.

STATEMENT OF THE CASE

Memphis Bank & Trust brought this action in the Chancery Court of Shelby County, Tennessee, Part III, on June 27, 1979, to recover $56,696.81 in taxes paid under protest to appellees Riley C. Garner, Shelby County Trustee, and Glenn E. Foster, Treasurer of the City of Memphis (J.A. 8a-12a, 36a). The taxes in question, covering the years 1977 and 1978, had been assessed pursuant to the so-called Tennessee bank tax, found at Section 67-751, *et seq.*, of the Tennessee Code Annotated, set out in pertinent part at pp. 3-5 above.

Under the terms of the bank tax, each bank doing business in Tennessee is required to pay to local governments of the State a tax of 3% of the bank's net earnings for the preceding fiscal year, less a portion of certain ad valorem property taxes paid for that year. The term "net earnings" is defined for purposes of the bank tax to include interest on obligations of the United States and its instrumentalities, as well as interest on bonds and other obligations of states other than Tennessee, but to exclude interest on obligations of Tennessee and its political subdivisions. [4] In addition to the bank tax, Memphis Bank &

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[4] The bank tax (Tenn. Code Ann. § 67-751) provides that "net earnings shall be calculated . . . as prescribed by chapter 27 of title 67." In that chapter and title at § 67-2704 the term "net earnings" is defined as "federal taxable income" (which includes interest on

Trust is subject to and annually pays the Tennessee corporate franchise tax (Tenn. Code Ann. § 67-2901, *et seq.*; set forth in pertinent part, Appendix, pp. 8a-9a), and the Tennessee corporate excise tax (Tenn. Code Ann. § 67-2701, *et seq.*; set forth in pertinent part, Appendix, pp. 10a-12a).

In its Complaint, as amended, Memphis Bank & Trust alleged that the bank tax, as applied to it, was in violation of 31 U.S.C. § 742 ("the federal exemption statute") and 12 U.S.C. §§ 2055, 2079 and 2134 ("the federal farm credit agency exemption statutes"), and thus was unconstitutional under the Supremacy Clause of the United States Constitution (J.A. 10a-11a, 18a-19a, 27a-31a). The Honorable William M. Leech, Jr., Attorney General for the State of Tennessee, intervened as a defendant and filed an Answer (J.A. 24a-26a). Thereafter, the parties entered into a Stipulation (J.A. 36a-41a), and submitted the case on cross-motions for summary judgment.

The parties agreed in the Stipulation that the bank tax was an intangible personal property tax; that, as applied to Memphis Bank & Trust, the tax was based on interest earned on certain federal obligations (U.S. Treasury Notes, U.S. Treasury Bills, and obligations of federal land banks, federal intermediate credit banks, and banks for cooperatives); and that, if the interest earned on such federal obligations was excluded from the computation, Memphis Bank & Trust would have no liability under the bank tax for the years in question (J.A. 36a-41a). The

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obligations of the United States and its instrumentalities, but does not include interest on obligations of a state or its political subdivisions; 26 U.S.C. §§ 61, 63 and 103, 31 U.S.C. § 742a), with certain adjustments. Under the adjustments, interest earned on the obligations of states other than Tennessee and their political subdivisions is added to "federal taxable income" to arrive at "net earnings."

Chancery Court granted Memphis Bank & Trust's motion for summary judgment (J.A. 62a, 69a), finding that the bank tax violates 31 U.S.C. § 742 and 12 U.S.C. §§ 2055, 2079 and 2134, and is thus unconstitutional under the Supremacy Clause of the United States Constitution, insofar as it includes in the measure of the tax interest earned on obligations of the United States and its instrumentalities (J.A. 61a-68a, 69a-71a).

The appellees herein appealed to the Supreme Court of Tennessee (J.A. 72a-73a) which reversed and held that the Tennessee bank tax does not violate the federal exemption statute (31 U.S.C. § 742) or the federal farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134) (J.A. 74a, 75a-81a). In reaching that conclusion, the court held that the bank tax is a local bank excise tax and not a direct tax on property (J.A. 76a); that the bank tax falls within the exceptions provided in the federal exemption statute for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations" (J.A. 79a), despite the fact that banks already pay the corporate franchise tax and the general corporate excise tax in Tennessee; and that the bank tax is not discriminatory because it does not treat federal obligations as "special or direct objects of taxation" (J.A. 79a-80a), even though the bank tax includes in its measure income from federal obligations while excluding income from obligations of the State of Tennessee. In sum, the Supreme Court of Tennessee found "nothing in either . . . 31 U.S.C. § 742, or . . . 12 U.S.C. §§ 2055, 2079 and 2134, or in the federal constitution which prohibits the measure of the bank excise tax by its federal taxable income, *including interest on federal obligations*" (J.A. 80a; emphasis added).

SUMMARY OF ARGUMENT

Under the federal exemption statute (31 U.S.C. § 742) and the federal farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134) obligations of the United States, and the interest thereon, are exempt from taxation by States and their subdivisions. These statutes embody principles of constitutional law established for more than 150 years and derived from the "Borrowing" and "Supremacy" Clauses of the Constitution and the constitutional doctrines announced in *M'Culloch* v. *Maryland*. The Tennessee bank tax (Tenn. Code Ann. § 67-751, *et seq.*), which includes in its computation income from obligations of the United States and federal farm credit instrumentalities, violates the plain language of these statutes and the underlying constitutional principles.

A 1959 amendment to the federal exemption statute codified a long-standing judicial exception to the rule against taxation of federal obligations and the income therefrom for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof." The bank tax, however, does not fit within either of these exceptions. First, the bank tax, imposed in addition to the state franchise and general corporate excise taxes, is not a franchise tax. Second, the bank tax, which is specifically imposed, administered and collected as a tax on property or in lieu of a tax on property, is not a nonproperty tax. In any event, regardless of how it is characterized, the bank tax discriminates against federal obligations in that interest on federal obligations is included in the tax, but interest on obligations of Tennessee and its subdivisions is excluded. Thus, the bank tax is not a nondiscriminatory franchise or other nonproperty tax in lieu thereof and so does not fall within any of the exceptions in the federal exemption statute.

By thus taxing interest on obligations of the United States and the federal farm credit system, the bank tax diminishes the market value and investment attractiveness of these obligations. As a result, the bank tax obstructs the exercise by the federal government of its power under the Borrowing Clause of the Constitution—the very result these exemption statutes were designed to prevent.

ARGUMENT

THE TENNESSEE BANK TAX VIOLATES 31 U.S.C. § 742 AND 12 U.S.C. §§ 2055, 2079 AND 2134 AND IS REPUGNANT TO THE CONSTITUTION.

I.

THE BANK TAX VIOLATES 31 U.S.C. § 742.

A. Interest On Obligations Of The United States Is Exempt From Taxation By States And Their Subdivisions.

Under the plain language of the federal exemption statute, obligations of the federal government and the interest therefrom are "exempt from taxation by or under State or municipal or local authority." 31 U.S.C. § 742. The Tennessee bank tax, which taxes the income from federal obligations, violates this exemption.

In 1829 this Court decided that, as a matter of constitutional law, obligations of the federal government are immune from state taxation. *Weston* v. *City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829). The principle announced in *Weston* was derived from the "Borrowing" and "Supremacy" Clauses of the Constitution, and the constitutional doctrine announced in *M'Culloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819). *Society for Savings*

v. *Bowers*, 349 U.S. 143, 144 (1955). This Court has explained the principle as follows:

> "The Constitution has conferred upon the Government power to borrow money on the credit of the United States, and that power cannot be burdened or impeded or in any way affected by the action of any State." *Home Savings Bank* v. *Des Moines*, 205 U.S. 503, 513 (1907).

It was not until the Civil War, when Congress authorized the issuance of large amounts of national securities, that it was thought necessary to express this constitutional prohibition in an act of Congress. It was so important to sustain the credit of the federal government at that critical time that, in authorizing the issuance of national securities in 1862, Congress provided that "all stocks, bonds, and other securities of the United States held by individuals, corporations, or associations, within the United States, shall be exempt from taxation by or under State authority." Act of February 25, 1862, ch. 33, 12 Stat. 345, 346. *See Home Savings Bank* v. *Des Moines*, 205 U.S. at 513-514.

Virtually identical language was carried forward after 1862 in acts authorizing the issuance of government securities.[5] The comments of Senator Sherman of Ohio in debate preceding the enactment of one such act (Act of July 14, 1870, ch. 256, 16 Stat. 272) clearly emphasized

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[5] *See, e.g.*, Act of March 3, 1863, ch. 73, § 1, 12 Stat. 709; Act of March 3, 1864, ch. 17, § 1, 13 Stat. 13; Act of June 30, 1864, ch. 172, § 1, 13 Stat. 218; Act of January 28, 1865, ch. 22, § 1, 13 Stat. 425; Act of March 3, 1865, ch. 77, § 2, 13 Stat. 468; Act of July 14, 1870, ch. 256, § 1, 16 Stat. 272.

the importance of the exemption principle to the operation of the federal government.

> "The exemption of these bonds from State taxation is not a legislative question. If there was no provision in this bill about State taxation they would not be taxable by the States, because by the Constitution of the United States itself, according to the decisions of the Supreme Court in many cases, no State can tax a Government security. This has been settled from 1819 down to this time by the concurrence of every judge who has sat upon the Supreme bench, in a series of decisions all speaking to the same effect, that under no possible circumstances can a State levy any tax upon a security of the Government of the United States. Why? Simply because *the power to borrow money is necessary to our national existence, and if a State could tax the power of the United States to borrow money it might just as well tax the soldiers of our Army, our guns, and our gunpowder.*" Cong. Globe, 41st Cong., 2d Sess. 1591 (1870); emphasis added.

Thus, the federal exemption statute as originally enacted was intended to provide crucial protection to the continuing ability of the federal government to implement its borrowing power. Indeed, as this Court has stated, the intent of Congress in enacting 31 U.S.C. § 742 was "to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith* v. *Davis*, 323 U.S. 111, 117 (1944).

In 1959, to curtail attempts by the states to circumvent the exemption statute, Congress amended 31 U.S.C. § 742 by adding the following sentence:

> "This exemption extends to *every form* of taxation that would require that either the obligations or the interest thereon, or both, be considered, *directly or*

> *indirectly*, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes." 31 U.S.C. § 742; emphasis added.

The purpose of the foregoing amendment was to "clarify" the exemption statute by making its prohibition more specific and thereby foreclose attempts by the states to sidestep the federal exemption rule. S. Rep. No. 909, 86th Cong., 1st Sess. 8 (1959).[6] The Tennessee bank tax clearly violates 31 U.S.C. § 742 since it uses in its computation the earnings from obligations of the United States and its instrumentalities. Certainly there can be no doubt on this point in light of the "clarifying" amendment added to the statute in 1959.

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[6] More specifically, the amendment was aimed at an attempt by the state of Idaho, and similar attempts by other states, to evade the exemption rule by taxing federal obligations only indirectly. *See Public Debt Ceiling and Interest Rate Ceiling on Bonds: Hearings Before the House Committee on Ways and Means*, 86th Cong., 1st Sess. 69-72 (1959) (Statement of Hon. Robert B. Anderson, Secretary of Treasury). Like the Tennessee bank tax involved here, the Idaho tax statute was defended on the ground that income from federal obligations was not the object of the tax, but was merely a part of the measure of the tax. In testimony before the House Ways and Means Committee, Secretary of Treasury Robert B. Anderson dismissed this defense as "a distinction of words which is without substance." *Id.* at 71. He further testified that the simplest solution to the problem posed by statutes such as the Idaho statute would be to "clarify" the exemption by "expressly exempting" federal obligations and the interest on them from state and local taxing authority. *Id.* Stressing the need for such clarification, Secretary Anderson stated that "[i]f positions such as Idaho has held are adopted by other States the resulting taxation . . . could have undesirable effects on Treasury financing operations." *Id.* at 72.

B. The Bank Tax Does Not Fall Within Any Of The Exceptions Provided In 31 U.S.C. § 742 For "Nondiscriminatory Franchise Or Other Nonproperty Taxes In Lieu Thereof Imposed On Corporations."

Not only does the Tennessee bank tax violate the express prohibition contained in the first sentence of 31 U.S.C. § 742, it also does not fall within any of the exceptions provided in the second sentence of that statute. The bank tax is not a franchise tax, nor is it a nonproperty tax; moreover, the tax is discriminatory.

1. The Bank Tax is not a Franchise Tax.

In its opinion below the Supreme Court of Tennessee stated that the bank tax is "purely an excise tax" (J.A. 76a). From this premise the Court concluded, in a curious twist of logic, that since the state's general corporate excise tax, as well as the state's franchise tax, had "long been held" to be "taxes laid upon the privilege of doing business in corporate form and of exercising the corporate franchise" in Tennessee, the bank tax must necessarily be "a corporate privilege tax" (J.A. 76a-79a). The bank tax, however, is in the nature of an "excise" tax only in the manner of its computation. As demonstrated below, the bank tax, levied as a tax on a subclassification of intangible personal property and codified with other direct taxes on corporate and business property, was clearly imposed by the Tennessee legislature as a tax on property or in lieu of a tax on property; therefore, it cannot be a privilege tax. Indeed, it is the state franchise tax—by its own terms a "privilege tax"—which is imposed for the "privilege of engaging in business in corporate form" in Tennessee (Tenn. Code Ann. § 67-2902, Appendix, p. 8a). This franchise tax, which is so denominated (Tenn. Code Ann. § 67-2901, Appendix, p. 8a) and separately applies to banks as well as corporations

generally, is measured by the issued and outstanding stock, surplus and undivided profits of each corporation. Tenn. Code Ann. § 67-2903, Appendix, p. 9a. Moreover, the general corporate excise tax, which also separately applies to banks as well as corporations generally, is the tax measured by net earnings which is exacted from banks "as compensation for the benefits . . . [received] from doing business in Tennessee." Tenn. Code Ann. §§ 67-2702, 67-2704, Appendix, pp. 10a-12a. This general corporate excise tax, which like the corporate franchise tax is by its own terms a privilege tax, is codified separately in chapter 27 of the Taxes and Licenses Title.

It is of particular significance that the bank tax is not imposed in lieu of all other taxes but in addition to the franchise tax and the general corporate excise tax. Cf. *Provident Savings Institution* v. *Massachusetts*, 73 U.S. (6 Wall.) 611, 631 (1868) and *Hamilton Manufacturing Co.* v. *Massachusetts*, 73 U.S. (6 Wall.) 632, 638 (1868) (Taxes determined to be franchise taxes where in lieu of all other taxes). In short, this tax on banks is not a franchise tax in name or in operation or effect.

In a case recently decided by the Supreme Court of Rhode Island, *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981), a tax strikingly similar to the Tennessee bank tax was held not to be a franchise tax. The tax involved in that case was the "Rhode Island Business Corporation Tax" which, like the Tennessee bank tax, was measured by income including interest derived from federal securities. Although the Rhode Island tax did not directly tax federal interest, it did include that interest, together with proceeds of sale of federal securities, in gross receipts, which formed the basis for allocating in-state and out-of-state income. The Supreme Court of

Rhode Island, noting that inclusion of the tax-exempt obligations in the measure of the tax increased the tax assessed by more than $11,000, concluded that the tax was "an indirect tax upon federal securities and, thus, invalid" under the federal exemption statute, 31 U.S.C. § 742. 429 A.2d at 449. As to the franchise tax exception contained in that statute, the court stated:

> "It is clear, however, that the tax in the case at bar was not a franchise tax. The tax was instead levied pursuant to . . . the Business Corporation Tax, and not pursuant to . . . the Corporate Franchise Tax [to which the taxpayer was also subject]." 429 A.2d at 449-540; citations omitted.

The Tennessee bank tax is no more a franchise tax than the tax at issue in *Federal Products Corp.*, and thus cannot fit within the franchise tax exception contained in 31 U.S.C. § 742.

2. The Bank Tax is not a Nonproperty Tax.

As noted above, 31 U.S.C. § 742 provides an exception for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof." The Tennessee bank tax, as demonstrated above, is not a franchise tax; it is not a nonproperty tax in lieu thereof, either.

The stipulation of the parties below repeatedly (19 times) refers to the bank tax as an intangible personal property tax. In the first two sentences the statute itself (Tenn. Code Ann. § 67-751) refers to the tax as a tax on "intangible personal property" and then provides that "in lieu of the assessment according to the value and taxation of its intangible personal property," each bank will pay a tax of 3% of its net earnings. In the last sentence the statute provides that the tax is imposed in lieu of taxes on various specific types of intangibles and "other intangible corporate property," but not in lieu of ad valorem taxes on

tangible realty and personalty. Furthermore, subsection B of the act which enacted the bank tax (1977 Tenn. Pub. Acts, ch. 140; Appendix, pp. 4a-7a), codified as Tenn. Code Ann. § 67-752, imposes a minimum tax at least equal to the ad valorem tax on 60% of the book value of the bank's shares. Finally, subsection D of the act (Appendix, p. 7a), Tenn. Code Ann. § 67-754, provides, with exceptions not relevant here, for the tax to be allocated between county and municipality on the basis of their respective property tax rates.

The preamble to the act (Appendix, pp. 4a-5a) shows that the Tennessee Legislature was acting under the provision of the Tennessee Constitution, art. 2, § 28 (set forth in pertinent part, Appendix, p. 3a), which empowers it to classify and assess intangible personal property. Cf. *Provident Savings Institution* v. *Massachusetts*, 73 U.S. (6 Wall.) 611, 623-628 (1868) and *Hamilton Manufacturing Co.* v. *Massachusetts*, 73 U.S. (6 Wall.) 632, 637 (1868) (In determining that taxes were franchise taxes, Court considered state constitutional authority under which legislature acted). Moreover, in taxing banks Tennessee has historically imposed intangible personal property taxes in addition to the separate franchise and excise taxes. 1907 Tenn. Pub. Acts, ch. 602, § 24; Tenn. Code (Shan.) § 790 (1917); 1927 Tenn. Pub. Acts, ch. 39, § 1; Tenn. Code § 1391 (1932); see *Bank Tax Case*, 69 U.S. (2 Wall.) 200, 209 (1865) (In determining that tax was not a franchise tax, Court considered state's history of taxing institutions' property rather than their privileges and franchises). Furthermore, in contrast to the franchise and general corporate excise taxes, the bank tax is codified in the same title and chapter as other direct taxes on corporate and business property (Title 67, Taxes and Licenses, Chapter 7, Assessment of Corporate and Busi-

ness Property), and provisions for payment and collection of the tax are the same as for other property taxes (Tenn. Code Ann. §§ 67-759, 67-760, 67-1101, 67-1104). *Cf. Provident Savings Institution* v. *Massachusetts*, 73 U.S. (6 Wall.) at 631-632 (Means of assessing and collecting tax noted in finding tax to be a franchise tax).

In addition, Memphis Bank & Trust is subject to and annually pays the Tennessee franchise tax imposed under Tenn. Code Ann. § 67-2901, *et seq.* Therefore, the bank tax is not "in lieu" of the franchise tax since Memphis Bank & Trust must pay both.

3. The Bank Tax is Discriminatory.

Whether or not the bank tax is viewed as a franchise tax or other nonproperty tax in lieu thereof, it is discriminatory nevertheless and, therefore, cannot fall within the exception of 31 U.S.C. § 742 for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations."[7] Under Tennessee's bank tax, income from obligations of the United States and its instrumentalities is taxed, while income from obligations of Tennessee and its political subdivisions is not taxed (*see* n. 4, above). The bank tax thus discriminates against federal obligations.

This Court has not had occasion to interpret the meaning of "nondiscriminatory" in 31 U.S.C. § 742 since it was added by amendment in 1959. It has, however, frequently considered the term in the context of the preexisting and long-established judicial exception to the rule against

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[7] The nondiscrimination requirement in 31 U.S.C. § 742 applies to both franchise taxes and other nonproperty taxes. This is apparent from the statute and clear from the legislative history to the 1959 amendment. S. Rep. No. 909, 86th Cong., 1st Sess. 8 (1959).

taxation of federal obligations and the income therefrom for certain nondiscriminatory taxes. *See, e.g., Werner Machine Co.* v. *Director of Taxation*, 350 U.S. 492, 493-494 (1956); *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals*, 338 U.S. 665, 675 (1950); *Schuylkill Trust Co.* v. *Pennsylvania*, 296 U.S. 113, 119-120 (1935); *see also Home Insurance Co.* v. *New York*, 134 U.S. 594, 601 (1890). The general rule of these and other cases is that a tax statute discriminates against obligations of the United States where it imposes a higher tax on taxpayers who hold federal obligations than on those who hold other assets.

This rule is illustrated by the *Schuylkill Trust Co.* case which held "discriminatory," and thus invalid, a state tax statute exempting securities of state corporations from the measure of tax while denying such exemption to federal government securities and those issued by federal instrumentalities. The Court there stated:

> "If the tax is lifted from the shares of certain trust companies because those companies own only stocks already taxed or relieved from taxation by the state, and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities which are figured in the base of the tax, *it is impossible to avoid the conclusion that the law discriminates in favor of the former and against the latter solely by reason of ownership of such federal securities.*" 296 U.S. at 120; emphasis added. *See also New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals*, 338 U.S. 665 (1950).

The rule is similarly stated in other cases. For example, in *Werner Machine Co., supra*, the Court rejected the

idea that the particular franchise tax at issue there was discriminatory, stating:

> "Since [unlike the Tennessee bank tax] the tax remains the same whatever the character of the corporate assets may be, no claim can be sustained that this taxing statute discriminates against the federal obligations." 350 U.S. at 493-494.

The same concept is evident as long ago as 1890, when this Court, in upholding a state franchise tax in *Home Insurance Co.* v. *New York*, 134 U.S. at 601, noted:

> "The tax in the present case would not be affected if the nature of the property in which the whole capital stock is invested were changed and put into real property or bonds of New York, or of other States."

The principle embodied in *Schuylkill*, *Werner* and these other cases as to the meaning of "discriminatory" was applied by the Supreme Court of Pennsylvania to invalidate a tax strikingly similar to the Tennessee bank tax. *Commonwealth* v. *Curtis Publishing Co.*, 69 A.2d 410 (Pa. 1949), *cert. denied*, 339 U.S. 928 (1950). In *Curtis* the court considered the validity of the Pennsylvania Corporate Net Income Tax Act, as in effect in 1942, which included interest on federal securities, but excluded interest on state and municipal securities and dividends from corporate stock, in arriving at the "net income" on which the tax was computed. The court held, relying heavily on *Schuylkill* and related decisions of this Court, that the inclusion of interest on federal obligations in net income resulted in an unconstitutional discrimination against those obligations because obligations of Pennsylvania and its subdivisions remained untaxed.[8] 69 A.2d at

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[8] Pennsylvania, like Tennessee in the present case, imposed a tax on income as determined for federal tax purposes (with minor adjustments not relevant here). Because income for federal tax purposes

422. Furthermore, the court observed that because of the potential widespread holding of federal obligations by Pennsylvania corporations, the operation of the tax would

> "to a very substantial degree impair the marketability of national securities in Pennsylvania. A discrimination effecting such a result cannot be dismissed as merely 'casual or incidental'. . . .
>
> . . . The purpose of the applicable constitutional provisions [the Supremacy Clause and the Borrowing Clause] as enunciated by the Supreme Court is to prevent discrimination against securities of the United States which would be prejudicial to them when they are offered for sale in competition with state and municipal securities. When Pennsylvania *exempts* from taxation its own securities but *taxes*, directly or indirectly, the securities of the *United States* the latter securities are handicapped in their competition with the securities of Pennsylvania, among buyers in the market place. This handicapping is by implication proscribed by the Constitution of the United States." 69 A.2d at 421; original emphasis.

As these cases demonstrate, the Tennessee bank tax is clearly discriminatory within the meaning of 31 U.S.C. § 742. The amount of the bank tax will vary depending on the extent to which a bank holds federal obligations as opposed to Tennessee obligations. Thus, the higher the proportion of assets invested in obligations of the State of Tennessee and its political subdivisions, the lower the amount of the bank tax. The practical effect of this dis-

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included income from federal obligations but excluded income from state obligations, income for state tax purposes similarly included income from federal obligations but excluded income from state obligations.

crimination is to discourage a bank from investing in federal obligations, a result the exemption statute is intended to prevent. *Smith* v. *Davis*, 323 U.S. at 117. The Tennessee bank tax thus obstructs the borrowing power of the United States.

The same "nondiscriminatory" concept embodied in the federal exemption statute is also found in a line of recent cases dealing with the relationship between the general authority of states to tax and the sovereignty of the United States and its instrumentalities. As a general rule, although a state may not lay a tax directly on the federal government, *United States* v. *New Mexico*, ___ U.S. ___, 102 S.Ct. 1373, 1382 (1982); *Mayo* v. *United States*, 319 U.S. 441, 447 (1943), it may impose other taxes which are nondiscriminatory. *United States* v. *County of Fresno*, 429 U.S. 452, 460 (1977); *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 150 (1937). This rule is consistent with the federal exemption statute, and the validity of nondiscriminatory indirect taxes corresponds to the exception under 31 U.S.C. § 742 for nondiscriminatory franchise taxes. In this context, too, the test for discrimination is whether the tax is imposed equally on similarly situated taxpayers or imposes a greater tax burden on the federal government or those with whom it does business. *United States* v. *County of Fresno*, 429 U.S. at 462; *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744, 751 (1961); *Phillips Co.* v. *Dumas School District*, 361 U.S. 376, 382-387 (1960). *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 494-495 (1958). The concern underlying this rule is that the United States must be protected in the exercise of its government functions from interference by the states. *James* v. *Dravo Contracting Co.*, 302 U.S. at 157; *see also United States* v. *New Mexico*, 102 S. Ct. at 1382.

In the instant case, particularly since the statute (31 U.S.C. § 742) is designed to protect the power of the United States to borrow money, the issue is not whether a bank in Tennessee is taxed more onerously than some other business in the state, as the Supreme Court of Tennessee suggests in its opinion (J.A. 80a). Rather, the issue is whether the tax is imposed on federal obligations but not on state obligations. It is this type of discrimination, clearly present in the instant case, which puts an unconstitutional burden on the borrowing power.

II.

THE BANK TAX VIOLATES 12 U.S.C. §§ 2055, 2079 AND 2134.

The bank tax, as applied to Memphis Bank & Trust, also violates the specific federal farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134), which exempt from state tax income from obligations of federal land banks, federal intermediate credit banks, and banks for cooperatives. Each of these instrumentalities is a part of the federal Farm Credit System, and although these exemptions were recently reenacted by the Farm Credit Act of 1971 (Pub. L. 92-181, §§ 1.21, 2.8, 3.13, 85 Stat. 583, 590, 597, 608), interest from obligations, and the obligations themselves, of each instrumentality has been exempt from state taxation since its creation.[9]

Before enacting the first of these exemptions, Congress considered at length both the constitutional basis

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[9] *See* Federal Farm Loan Act of 1916, ch. 245, § 26, 39 Stat. 360, 380 (federal land banks); Agricultural Credits Act of 1923, ch. 252, § 2, 42 Stat. 1454, 1459 (federal intermediate credit banks); Farm Credit Act of 1933, ch. 98, § 63, 48 Stat. 257, 267 (banks for cooperatives).

for the exemption and its practical effect. *See* 53 Cong. Rec. 6851-6854, 6961-6970, 7245-7247, 7305-7318, 7372-7378, 7537 (1916). This debate and the committee reports accompanying the act make clear that the purpose of the Federal Farm Loan Act was to provide loans for agricultural purposes at the lowest possible interest rates, and that by so protecting the instrumentality from state taxation, Congress intended to keep the interest rates down and to spare the farmer the burden of bearing the cost of an additional layer of taxes. S. Rep. No. 144, 64th Cong., 1st Sess., 1, 2, 4, 7-9 (1916); H.R. Rep. No. 630, 64th Cong., 1st Sess., 4, 5 (1916); H. Doc. No. 494, 64th Cong., 1st Sess., 8 (1916); 53 Cong. Rec. 6693, 7021, 7023, 7024, 7312, 7391, 7537, 7714, 7989 (1916).

Soon after the first of these instrumentalities was created, this Court upheld the constitutionality of the Federal Farm Loan Act and the validity of the tax exemption provisions. *Smith* v. *Kansas City Title & Trust Co.*, 255 U.S. 180 (1921). This position has since been reaffirmed on numerous occasions. *See, e.g.*, *Federal Land Bank* v. *Crosland*, 261 U.S. 374 (1923); *Federal Land Bank* v. *Bismark Lumber Co.*, 314 U.S. 95 (1941); *Federal Land Bank* v. *Kiowa County*, 368 U.S. 146 (1961).

Although instrumentalities of the federal government such as federal land banks, intermediate credit banks and banks for cooperatives may be exempt from state taxation as a matter of constitutional law, *see Federal Land Bank* v. *Kiowa County*, 368 U.S. at 149; *M'Culloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819); *Osborn* v. *United States Bank*, 22 U.S. (9 Wheat.) 738 (1824), this Court has stressed that "Congress has the power to determine, within the limits of the Constitution, the extent that its instrumentalities shall enjoy immunity from state taxation." *Federal Land Bank* v. *Kiowa County*, 368

U.S. at 149. Accordingly, this Court has looked to the specific language of the federal agency exemption statute in enforcing the exemption. Moreover, this Court has rejected a narrow construction of the statute, emphasizing in one case that it will not permit the protection of Section 26 of the Federal Farm Loan Act (12 U.S.C. § 2055) to be "frittered away." *Federal Land Bank* v. *Bismark Lumber Co.*, 314 U.S. at 99.

The plain language of these specific exemption statutes leaves no room for a state or local tax, such as the Tennessee bank tax, on income from obligations of these federal instrumentalities. Under 12 U.S.C. § 2055, Appendix, p. 1a, the obligations issued by federal land banks "shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from *all* Federal, State, municipal and local taxation" (emphasis added). [10] Obligations of federal intermediate credit banks are accorded identical treatment under 12 U.S.C. § 2079, Appendix, p. 1a. Similarly, 12 U.S.C. § 2134, Appendix, pp. 1a-2a, establishes banks for cooperatives as instrumentalities of the United States and, as such, obligations issued by them are exempt "both as to principal and interest from *all* taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial or local taxing authority" (emphasis added).

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[10] Although not relevant to this case, *cf.* 31 U.S.C. § 742(a), with respect to federal taxation.

CONCLUSION

For all of the foregoing reasons, this Court should reverse the judgment of the Supreme Court of Tennessee and hold that the Tennessee bank tax, as applied to Memphis Bank & Trust, is unconstitutional and violates the federal exemption statute (31 U.S.C. § 742) and the federal farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134), insofar as it includes obligations of the United States and its instrumentalities, or the interest thereon, in the computation of the tax.

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Federal Farm Credit Agency Exemption Statutes

12 U.S.C. § 2055. Taxation

Every Federal land bank and every Federal land bank association and the capital, reserves, and surplus thereof, and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by a Federal land bank or a Federal land bank association to the same extent, according to its value, as other similar property held by other persons is taxed. The mortgages held by the Federal land banks and the notes, bonds, debentures and other obligations issued by the banks or associations shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 742(a)).

12 U.S.C. § 2079. Taxation

Every Federal intermediate credit bank and the capital, reserves, and surplus thereof and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation except taxes on real estate held by a Federal intermediate credit bank to the same extent, according to its value, as other similar property held by other persons is taxed. The obligations held by the Federal intermediate credit banks and the notes, bonds, debentures, and other obligations issued by the banks shall be deemed to be instrumentalities of the Government of the United States, and, as such, they and the income thereform shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 742(a)).

12 U.S.C. § 2134. Taxation

Each bank for cooperatives and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such bank shall be exempt, both as to principal and interest

from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority. Such banks, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, territorial, or local taxing authority; except that interest on the obligations of such banks shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941 (31 U.S.C. 742(a)) and except that any real and tangible personal property of such banks shall be subject to Federal, State, territorial, and local taxation to the same extent as similar property is taxed. The exemption provided in the preceding sentence shall apply only for any year or part thereof in which stock in the bank for cooperatives is held by the Governor of the Farm Credit Administration.

Tennessee Constitution, art. 2, § 28

Taxable property—Valuation—Rates.—In accordance with the following provisions, all property real, personal or mixed shall be subject to taxation, but the Legislature may except such as may be held by the State, by Counties, Cities or Towns, and used exclusively for public or corporation purposes, and such as may be held and used for purposes purely religious, charitable, scientific, literary or educational, and shall except the direct product of the soil in the hands of the producer, and his immediate vendee, and the entire amount of money deposited in an individual's personal or family checking or savings accounts. For purposes of taxation, property shall be classified into three classes, to wit: Real Property, Tangible Personal Property and Intangible Personal Property.

* * *

The Legislature shall have power to classify Intangible Personal Property into subclassifications and to establish a ratio of assessment to value in each class or subclass, and shall provide fair and equitable methods of apportionment of the value of same to this State for purposes of taxation. Banks, Insurance Companies, Loan and Investment Companies, Savings and Loan Associations, and all similar financial institutions, shall be assessed and taxed in such manner as the Legislature shall direct; provided that for the year 1973, or until such time as the Legislature may provide otherwise, the ratio of assessment to value of property presently taxed shall remain the same as provided by law for the year 1972; provided further that the taxes imposed upon such financial institutions, and paid by them, shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, policies of insurance, customer savings and checking accounts, certificates of deposit, and certificates of investment, by whatever name called, including other intangible corporate property of such financial institutions.

* * *

1977 Public Acts Of The State Of Tennessee, Chapter 140, Section 1(A), (B), & (D)

WHEREAS, The people of Tennessee amended Article 2, Section 28 of the Constitution of Tennessee in August 1972; and

WHEREAS, The State Constitution, as amended, delegates certain powers to the Legislature relative to the assessment and taxation of intangible personal property and the assessment and taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions; and

WHEREAS, The State Constitution, as amended, empowers the Legislature to classify intangible personal property into subclassifications and to establish a ratio of assessment to value in each subclass; and

WHEREAS, The State Constitution further empowers the Legislature to direct the manner in which banks, insurance companies, loan and investment companies, savings and loan associations and similar financial institutions shall be assessed and taxed; and

WHEREAS, The State Constitution further empowers the Legislature to direct the manner in which the value and definitions of property in each class or subclass shall be ascertained; and

WHEREAS, The State Board of Equalization has conducted certain studies and made certain reports and recommendations to the General Assembly pursuant to Chapter 226 of the Public Acts of 1973; and

WHEREAS, The reports prepared by the State Board of Equalization show that there is great disparity and lack of uniformity in the manner in which intangible personal property assessments have been administered across the state; and

WHEREAS, House Joint Resolution 428 adopted by the Eighty-Ninth General Assembly authorized the appointment of a special joint committee to study the laws relating to taxation of intangible personal property and the laws relating to taxation of banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions and to report to

the Ninetieth General Assembly and the said committee has conducted a thorough study of these matters, has held public hearings and has made its report and recommendations to the Ninetieth General Assembly which report concluded that banks and banking associations require careful regulation and supervision by state and federal authorities to protect the interest of their depositors and assure their financial soundness and such regulatory authorities frequently request and often require that banks increase their capitalization; that the current manner of taxing bank shares discourages a strong capital structure contrary to the arms of the regulatory authorities and often penalizes new banks which are required to maintain higher capital ratios; that a manner of taxing the intangible value of bank shares based upon the net earnings of the bank would be more equitable and appropriate, but that any revision in the manner of taxing bank shares should contain provisions to assure the protection of the revenues currently received by county and municipal governments; and

WHEREAS, The Legislature affirms and supports the conclusions of the special committee which deal primarily with the taxation of bank shares and specifically reserves to itself the right to create further subclasses of intangible personal property and to determine the manner of taxation; now, therefore,

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 67, Chapter 7 is amended by adding the following new sections:

(A) Banks. There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible per-

sonal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by Tennessee Code Annotated, Title 67, Chapter 27. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever named called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under Tennessee Code Annotated, Title 67, Chapter 27 and all other taxes to which it is currently subject.

(B) Minimum Tax. In no event shall the tax imposed under subsection (A) upon any bank be less than an ad valorem tax calculated on the basis of sixty percent (60%) of the book value of the banks as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits.

In determining the value to be assessed, the following shall be deducted from the sixty percent (60%) book value:

(1) The appraised value of all real property and tangible personal property otherwise owned and assessed to companies subject to this tax; and

(2) The appraised value of all real property in Tennessee occupied by companies subject to this tax and used for the purpose of conducting their business under a lease which provides that all ad valorem taxes on such property shall be paid by such companies and said lease has been registered in the county where such property is located.

The remaining value shall be assessed at forty percent (40%) and the resulting assessment shall be the

amount to which the appropriate city and county tax rates shall be applied to determine the tax due and payable to the respective taxing jurisdictions.

* * *

(D) Allocation of Tax. Unless the tax imposed herein shall be calculated under Subsection (B), the total tax shall be allocated between the county and municipality where the principal office of the bank is located in the same proportion as the property tax rate of each taxing jurisdiction for the immediately preceding year shall bear to the sum of said property tax rates of both taxing jurisdictions.

* * *

Title 67, Tennessee Code Annotated

CHAPTER 29
CORPORATE FRANCHISE TAX

67-2901. Short title. — This chapter may be cited and referred to as "The Franchise Tax Law."

67-2902. Corporations subject to tax. — (a) All corporations, cooperatives, joint-stock associations, and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue, annually a privilege tax in addition to all other taxes, the rate and measure of which are hereinafter set forth. The tax shall be paid for the privilege of engaging in business in corporate form in this state and shall be in addition to all other taxes levied by any other statute.

(b) Every such taxable entity organized and existing under and by virtue of the laws of this or any other state, territory or country, or organized and existing without any specific statutory authority, now or hereafter doing business within this state, without domesticating or qualifying to do business in this state, or while its charter is forfeited, revoked or suspended, shall as a recompense for the protection of its local activities and as compensation for the benefits it receives from doing business in Tennessee, pay the tax imposed by this chapter.

(c) The tax imposed by this chapter shall apply to corporations whose business is being conducted by a receivership or trusteeship appointed by any court of competent jurisdiction and shall continue to accrue until such time as the corporation has been actually and legally dissolved or withdrawn from this state.

(d) There shall be exempt from the payment of the tax levied under this chapter any corporation organized under the laws of the state of Tennessee whose sole expressed corporate purpose is for the furthering of industrial development in communities throughout the state, and doing related matters thereto, and whose stockholders receive no income other than interest or dividends on money invested in said corporation for constructing industrial buildings and whose officers receive no compensation.

67-2903. Rate of tax. — The privilege tax hereby imposed shall be a tax of fifteen cents (15¢) on the one hundred dollars ($100), or major fraction thereof, of the issued and outstanding stock, surplus and undivided profits of each such corporation as shown by the books and records of such corporation at the close of its last fiscal year preceding the making of the sworn report hereinafter required. For purposes of this section "issued and outstanding" stock shall not include treasury stock.

* * *

Title 67, Tennessee Code Annotated

CHAPTER 27
EXCISE TAX ON CORPORATE EARNINGS

67-2701. Short title. — This chapter may be cited and referred to as "The Excise Tax Law."

67-2702. Corporations subject to tax — Rate. — (a) All corporations, cooperatives, joint-stock associations, and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue, annually an excise tax, in addition to all other taxes, equal to six per cent (6%) of the net earnings for the next preceding fiscal year for business done in this state.

(b) Every such taxable entity organized and existing under and by virtue of the laws of this or any other state, territory or country, or organized and existing without any specific statutory authority, now or hereafter doing business within this state, without domesticating or qualifying to do business in this state, or while its charter is forfeited, revoked or suspended, shall as a recompense for the protection of its local activities and as compensation for the benefits it receives from doing business in Tennessee, pay the tax imposed by this chapter.

(c) The tax imposed by this chapter shall apply to corporations whose business is being conducted by a receivership or trusteeship appointed by any court of competent jurisdiction and shall continue to accrue until such time as the corporation has been actually and legally dissolved or withdrawn from this state.

(d) There shall be exempt from the payment of the tax levied under this chapter the following:

(1) Any corporation organized under the laws of the state of Tennessee whose sole expressed corporate purpose is for the furthering of industrial development in communities throughout the state, and doing related matters thereto, and whose stockholders receive no income other than interest or dividends on money invested in said corporation for constructing industrial buildings and whose officers receive no compensation.

(2) Corporations organized for the purpose of erecting, owning or operating a common meeting place for more than one (1) Masonic Lodge, more than one (1) Lodge of Odd Fellows, or similar lodges, and which corporations could obtain general welfare charters, and in which corporations all the stock is owned by lodges participating in the common temple or meeting place, regardless of the type of charter held by said operating corporations, except on income received by said corporation as rentals for use for commercial purposes.

* * *

67-2704. "Net earnings" defined. — The term "net earnings" is defined as federal taxable income before the operating loss deduction and special deductions provided for in §§ 241 through 247 and 249 through 250 of the Internal Revenue Code as required to be reported by corporations under the Internal Revenue Code, subject to the following adjustments:

(a) There shall be added to the federal taxable income:

(1) Excise tax imposed by this state to the extent deducted in determining federal taxable income.

(2) Interest income earned on bonds and other obligations of other states or their political subdivisions less allowable amortization.

(3) Any deduction made pursuant to §§ 611-617 of the Internal Revenue Code to the extent the deduction when added with similar deductions in prior years exceeds the cost of the property.

(4) Gains not recognized pursuant to § 337 of the Internal Revenue Code.

(5) The charitable contributions deduction claimed under § 170 of the Internal Revenue Code.

(6) Any capital loss carrybacks or carryovers deducted pursuant to § 1212 (a) of the Internal Revenue Code.

(b) There shall be subtracted from the federal taxable income:

(1) Dividends earned by a parent corporation from a subsidiary corporation where such parent owns eighty percent (80%) or more of the stock of the subsidiary.

(2) Any amount included in federal taxable income but not taxable under the law of this state.

(3) Any net operating loss incurred, which is defined as the excess of allowable deductions over total income allocable to this state for the year of the loss, and which may be carried over and allowed in succeeding tax years until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than three (3) years after the taxable year in which the net operating loss occurs.

(4) A portion of the gain or loss on the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis.

(5) Actual charitable contributions made by the corporation during the fiscal year.

(6) Losses not deducted pursuant to § 337 of the Internal Revenue Code.

(7) Any capital losses incurred during the fiscal year and not deductible under § 1211 (a) of the Internal Revenue Code.

(8) Any expense, other than income taxes, not deducted in determining federal taxable income for which a credit against the federal income tax is allowable. This subdivision shall apply to taxable periods ending on and after December 31, 1977.

Appellee's Brief

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No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY, *Appellant*,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE, *Appellees*.

Appeal From The Supreme Court Of Tennessee

BRIEF OF APPELLEES, RILEY C. GARNER, SHELBY COUNTY TRUSTEE, AND GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE

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QUESTION PRESENTED

Does the Tennessee Bank Tax, *Tenn. Code Ann.* § 67-751, unconstitutionally require inclusion of federal securities income in calculation of the tax, thus violating the Federal Exemption Statute, Tit. 31 U.S.C. § 742, and Tit. 12 U.S.C. §§ 2055, 2079, and 2134, and the Supremacy Clause, Article VI of the United States Constitution?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

No. 81-1613

MEMPHIS BANK & TRUST COMPANY,

Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,

Appellees.

Appeal From The Supreme Court Of Tennessee

BRIEF OF APPELLEES, RILEY C. GARNER, SHELBY COUNTY TRUSTEE, AND GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE

INTRODUCTION

This appeal is from a final judgment of the Supreme Court of Tennessee entered November 30, 1981, upholding the constitutionality of a Tennessee statute, *Tenn. Code Ann.* § 67-751, hereinafter referred to as "The Tennessee Bank Tax."

Hereinafter, the parties will be referred to as they appear in this court, i.e., Memphis Bank & Trust Company as "Appellant" and Riley C. Garner, Shelby County Trustee, Glen E. Foster, Treasurer of the City of Memphis, Tennessee, and William M. Leech, Jr., Attorney General for the State of Tennessee, as "Appellees."

STATEMENT OF THE CASE

These Appellees do not controvert Appellant's statement of the case except in the following particulars.

The parties did not agree in the Stipulation filed in the trial court that the Tennessee Bank Tax is an intangible personal property tax. The parties agreed only that Appellant paid certain sums "representing intangible personal property taxes" (J.A. 36a-41a). These Appellees have always contended that the Tennessee Bank Tax is a nondiscriminatory franchise or other nonproperty tax in lieu thereof (J.A. 16a, 20a and 33a). Also, see these Appellees argument at pp. 9-13 of this Brief.

These Appellees also presented the alternative defenses that the Tennessee Bank Tax is authorized by 12 U.S.C. § 548 and that the former Tennessee Bank Shares Tax, *Tenn. Code Ann.* § 67-715, *et seq.*, would be revived in the event the present statute is found to be unconstitutional. However, the Supreme Court of Tennessee ruled that the Tennessee Bank Tax is a nondiscriminatory franchise tax and did not rule on the alternative defenses.

SUMMARY OF ARGUMENT

Pursuant to 12 U.S.C. § 548 and 31 U.S.C. § 742, interest on obligations of the United States can be considered in computing state taxes authorized by said sections.

The National Bank Shares Tax, 12 U.S.C. § 548, was originally passed in 1864. It provides four (4) alternative methods of state taxation, to-wit:

> The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income . . .

12 U.S.C. § 548 was amended in 1969 to provide that national banks shall be treated as state banks for purposes of taxation. The Supreme Court of Texas has ruled that the 1969 amendment was intended to broaden, rather than restrict, congressional consent to state taxation of national banks. There have been numerous court decisions that § 548 extends congressional consent for states to tax shares of national banks without deducting federal securities owned by the banks.

31 U.S.C. § 742, as amended in 1959, provides that obligations of the United States are exempt from state taxation, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof, imposed on corporations and estate taxes and inheritance taxes. It has been held by the Supreme Court of Texas that the 1959 Amendment to § 742 did not withdraw Congress' consent for the states to tax shares of national banks pursuant to § 548.

The Tennessee Bank Tax is a nondiscriminatory franchise or other nonproperty tax in lieu thereof imposed on corporations and, therefore, comes within the exception to § 742. States have a wide discretion in taxing corporations and it is immaterial that Appellant pays state franchise and excise taxes in addition to the Bank Tax. It has been generally held that a tax is a franchise tax if it requires that the earning of the income and the exercising

of the privilege of doing business in corporate form coincide before imposing tax liability. The Supreme Court of Tennessee has ruled that the Tennessee Bank Tax is a corporate excise tax and it is expressly stated in the Statute that it is an "excise tax." Whether the tax is denominated "franchise" or "excise" is irrelevant; the terms are interchangeable where, as here, the tax is upon corporate business privileges.

The Tennessee Bank Tax is a nondiscriminatory franchise tax because there is no evidence of arbitrary, capricious, or irrational classification in the imposition thereof. The Tennessee Bank Tax does not discriminate against federal obligations because it does not single out federal obligations for taxation and subjects all obligations to the tax, except obligations of the State of Tennessee and its subdivisions. The Tennessee Tax is also nondiscriminatory because it is not aimed at federal obligations and only affects them in a casual and incidental manner. In the context of a property tax, discrimination occurs because the tax is aimed at and directly assessed against the federal obligations or their income. In an excise tax, discrimination occurs when the tax, though disguised as an excise, is specifically aimed at and actually does impose a direct tax on the federal securities, in an effort to circumvent the prohibition against direct taxation, hence, the tax is not a *bona fide* excise tax.

There was no evidence offered in the trial court that obligations of Tennessee and its subdivisions substantially compete with obligations of the United States or that obligations of the United States or the borrowing power of the United States would be adversely affected by the Tennessee Bank Tax.

The Tennessee Bank Tax does not discriminate against the obligations of the Farm Credit System Banks because

the banks are individually liable for said obligations and the power of the United States to borrow money is not involved in said obligations and said obligations are not issued on the credit of the United States.

In the trial court, these Appellees took the position that the Tennessee Bank Tax is constitutional under both § 548 and § 742. These Appellees took the alternative position that if the Tennessee Bank Tax is unconstitutional under either or both of said sections, then the pre-1977 Bank Tax is revived. The Supreme Court of Tennessee ruled that the Bank Tax is a nondiscriminatory franchise tax and did not rule on its constitutionality under § 548 or on the question of revival.

Appellant's contention that the tax would be constitutional if, by administrative application, federal income is deleted from the "net earnings" formula is contradictory to the law of Tennessee. No portion of the tax could be exorcised because the Bank Tax itself does not establish the formula for calculation of "net earnings." *Tenn. Code Ann.* § 67-751 simply provides that "the net earnings shall be calculated in the same manner as prescribed by *Tenn. Code Ann.* § 67-2701, *et seq.*, (the Excise Tax). Because the allegedly offending calculation is mandated by the Excise Tax "net earnings" formula, there is absolutely no way that this formula can be severed from the statute to the extent that it may be constitutional.

ARGUMENT

I.

THE TENNESSEE BANK TAX DOES NOT VIOLATE 31 U.S.C. § 742

A. Interest On Obligations Of The United States Does Not Enjoy An Unqualified Exemption From Taxation By States And Their Subdivisions.

The Appellant contends that pursuant to 31 U.S.C. § 742, App. 1a, interest on obligations of the United States is exempt from taxation by states and their subdivisions with the sole exception of nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and estate taxes and inheritance taxes.

These Appellees contend that in addition to the aforesaid taxes, national banking associations are also subject to taxation by states and their subdivisions pursuant to 12 U.S.C. § 548, App. 2a.

12 U.S.C. § 548 originated in the Forty-First Section of the Act of Congress of 1864 (Act, June 3, 1864, c. 106, 13 Stat. 111), commonly denominated the "National Banking or National Currency Act," and was subsequently incorporated in § 5219, Rev. St. U.S. Said section provides:

> § 548. STATE TAXATION
>
> The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or

> measured by their net income, provided the following conditions are complied with: . . .

12 U.S.C. § 548 was amended in 1969 to provide that national banks shall be treated as state banks for purposes of taxation. App. 3a. In *Bank of Texas* v. *John Childs*, 615 S.W.2d 810 (Tex. App. 1981), the Supreme Court of Texas ruled that the 1969 Amendment was intended to broaden, rather than restrict, congressional consent to state taxation of national banks. See, S. REP. No. 91-530, 91st Cong., 1st Sess. (1969), reprinted in [1969] U.S. Code Cong. and AD. News 1077.

There have been numerous decisions that 12 U.S.C. § 548 extends congressional consent for states to tax shares of national banks without deducting federal securities owned by the bank. *Van Allen* v. *Assessors*, 3 Wall. 573 (1866); *National Bank* v. *Commonwealth of Kentucky*, 9 Wall. 353 (1870); *DesMoines National Bank* v. *Fairweather*, 263 U.S. 103 (1923). In considering whether the state could tax the shares of national banks whose capital was wholly invested in obligations of the federal government, the court in *Van Allen* relied upon the provisions of the National Bank Act and its express consent to state taxation of such shares. Another theory underpinning this rule was that the shareholders' interests in the bank are a separate property interest from the bank's ownership of its assets, so that a tax on the shares is not a tax on the federal securities owned by the bank, even though the value of the shares is measured by the value of the federal obligations.

This rationale was extended to cases involving shares of state chartered banks. Therefore, the state may impose a bank shares tax, and may also require its payment by the bank, even though the taxes are measured by corporate assets, which include federal obligations.

Cleveland Trust Company v. *Lander*, 184 U.S. 111 (1902); *Corry* v. *Baltimore*, 196 U.S. 466 (1905).

31 U.S.C. § 742 provides that United States obligations are subject to nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and estate taxes and inheritance taxes.

From 1870 until 1959, 31 U.S.C. § 742 provided as follows:

> Except as otherwise provided by law, all stocks, bonds and other securities of the United States held by individuals, corporations or associations, within the United States, shall be exempt from taxation by or under state authority.

By Public Law 86-346, Congress in 1959 added the following sentence to 31 U.S.C. § 742:

> This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

In *Bank of Texas* v. *John Childs*, *supra*, the court stated at 821, 822 as follows:

> "The legislative history of the 1959 Amendment to Article 3701 strongly indicates that Congress had no intention to withdraw the consent to state taxation of bank shares provided by § 5219. . . . This legislative history, therefore, confirms our conclusion that the purpose of Congress was to preserve, rather than expand, what the Supreme Court had construed to be the constitutional principle embodied in § 3701. *See Society for Savings in the City of Cleveland* v. *Bowers*, 349 U.S. 143, 147 (1955)."

Therefore, it is readily apparent that the States and their subdivisions have both statutory and judicial authority to consider income from obligations of the United States in computing taxes authorized by Congress and that this authority was preserved by the 1959 Amendment to 31 U.S.C. § 742 and broadened by the 1969 Amendment to 12 U.S.C. § 548.

B. The Tennessee Bank Tax Is A Franchise Or Other Nonproperty Tax In Lieu Thereof Imposed On Corporations.

The Federal Exemption Statute allows state consideration of federal obligation income in computing "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations. . . ." 31 U.S.C. § 742.

The Appellant has erroneously contended that the Bank Tax is not a franchise tax on corporations. In *Commerce Union Bank* v. *State Board of Equalization*, 615 S.W.2d 151 (Tenn. 1981), the Supreme Court of Tennessee recently analyzed the nature of the tax, 615 S.W.2d at 47:

> It is true that the tax is in lieu of an ad valorem tax, its administration is assigned to the Division of Property Assessments of the state, and the tax is payable to county and municipal governments. T.C.A. § 67-756. Nevertheless it is a *corporate excise tax and must be so regarded and administered.* (Emphasis added.)

Whether the tax is denominated "franchise" or "excise" is irrelevant; the terms are interchangable where, as here, the tax is upon corporate business privileges. *Bank of Commerce* v. *Senter*, 149 Tenn. 569 (1923); and see, *Reuben L. Anderson-Cherne, Inc.* v. *Commissioner of Taxation*, 226 N.W.2d 611 (Minn. 1975) *appeal dismissed*, 98 S.Ct. 181. Although the state constitution

authorizes levies upon intangible personality such as the shares of banks, it also grants to the Legislature broad powers and discretion in assessing privilege taxes. Const., Art. 2 § 28; *Bank of Commerce* v. *Senter, supra.* The Legislature could have enacted both an intangible property tax and a bank excise tax; its election to provide only the excise tax does not convert the statute into an ad valorem tax.

That the Appellant pays other state excise and franchise assessments does not transmute the Bank Tax into a property tax, for, as the Legislative Special Joint Committee determined, "it is proper for banks to be taxed at a higher rate of taxation than other corporations because of certain privileges they enjoy" (J.A. 57a, 58a). Also, see *Bank of Commerce* v. *Senter, supra.* The Bank Tax plainly applies only to "each bank" exercising the privilege of "doing business in this state." *Tenn. Code Ann.* § 67-751, App. 4a. Omission of the word "privilege" does not alter the character of the tax. In upholding a Michigan statute styled a personal property tax which was in part based upon the value of property owned by the Federal Government, this Court pointed out:

> It is true that the particular Michigan taxing statutes involved here do not expressly state that the person in possession is taxed "for the privilege of using or possessing" personal property, but to strike down a tax on the possessor because of such verbal omission would only prove a victory for empty formalisms. . . . the state could obviate such grounds for invalidity by merely adding a few words to its statutes. Yet their operation and practical effect would remain precisely the same.

City of Detroit v. *Murray Corporation of America*, 355 U.S. 489, 493 (1957). The Appellant's contention that the

challenged tax is something other than a true excise or franchise tax is without merit.

The general rule is that a tax is a franchise tax if it requires that the earning of the income and the exercising of the privilege of doing business in corporate form coincide before imposing tax liability. *Educational Films Corp.* v. *Ward*, 282 U.S. 379 (1931); *Flint* v. *Stone Tracy Co.*, 220 U.S. 107 (1911); *Reuben L. Anderson-Cherne, Inc.* v. *Commissioner of Taxation, supra.*

In *Flint* v. *Stone Tracy Co., supra*, at 145 this Court stated as follows:

> "While the mere declaration contained in a statute that it shall be regarded as a tax of a particular character does not make it such if it is apparent that it cannot be so designated consistently with the meaning and effect of the act, nevertheless the declaration of the law making power is entitled to much weight, and in this statute the intention is expressly declared to impose a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company or association, or insurance company. It is, therefore, apparent, giving all the words of the statute effect, that the tax is imposed not upon the franchises of the corporation, irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate or insurance business, and with respect to the carrying on thereof, . . ."

The Tennessee Bank Tax expressly states that it is an "excise tax." Also, the Tennessee Legislative Committee characterized the tax as an "excise tax" (J.A. 58a).

In *Spreckels Sugar Refining Company* v. *McClain*, 192 U.S. 397 (1904), this court, in declaring an act taxing

the refining of sugar as an excise tax and not a direct tax on property, stated at 411 as follows:

> "It cannot be otherwise regarded because of the fact that the amount of the tax is measured by the amount of the gross annual receipts. The tax is defined in the Act as "a special excise tax" and, therefore, it must be assumed, for what it is worth, that Congress had no purpose to exceed its powers under the Constitution, but only to exercise the authority granted to it of laying and collecting excises."

The Appellant contends, for the first time, in this Court that the parties stipulated in the trial court that the tax in question is an intangible personal property tax. However, Appellant never made this contention in its Brief or argument in the Supreme Court of Tennessee. These Appellees deny that the legal character of the tax was stipulated and would point out that the Stipulation filed in the trial court stipulated only the fact that the Appellant paid a certain sum "representing intangible personal property taxes" (J.A. 36a). This was the Appellant's contention in its Complaint (J.A. 9a), and was so stipulated by the parties as being the contention of the Appellant. These Appellees have always contended that the tax in question is a nondiscriminatory franchise or other non-property tax in lieu thereof, Answer to original Complaint (J.A. 16a); Answer to First Amended Complaint (J.A. 20a), and Answer to Second Amended Complaint (J.A. 33a). These Appellees also briefed and argued this question in the Supreme Court of Tennessee.

It is true, that the Division of Property Assessments of the State of Tennessee characterized the tax in question as an intangible personal property tax and the tax schedule prepared by said Division, and submitted by the Appellant, also characterized the tax as an intangible personal property tax. However, it is submitted that said

characterization of the tax is immaterial since the characterization of a tax is a question of law and not a question of fact and a court is not bound by the parties' stipulations of law. *Swift and Company* v. *Hocking Valley Ry. Co.*, 243 U.S. 281 (1917); *Equitable Life Assur. Soc. of the United States* v. *MacGill*, 551 F.2d 978 (5th Cir. 1977), rehearing denied, 554 F.2d 1065 (5th Cir. 1977); *King* v. *United States*, 641 F.2d 253 (5th Cir. 1981) and *Los Angeles Shipbuilding and Drydock Corp.* v. *U.S.*, 289 F.2d 222 (9th Cir., 1961).

Also, the construction of a statute is a matter of law to be resolved by the court. *Bingham's Trust* v. *Commissioner of Internal Revenue*, 325 U.S. 365 (1945); *United Parcel Service, Inc.* v. *U.S. Postal Service*, 455 F.Supp. 857, affirmed 604 F.2d 1370 (3rd Cir. 1979), *cert. denied* 446 U.S. 957 (1980); *Intern. Soc. for Krishna Consciousness* v. *Rochford*, 425 F.Supp. 734 (Ill. 1977) and *Bryant* v. *Am. Nat. Bank and Trust Co. of Chicago*, 407 F.Supp. 360 (Ill. 1976).

Moreover, the Supreme Court of Tennessee has ruled that the tax is a franchise tax. *Commerce Union Bank* v. *State Board of Equalization, supra.*

C. The Tennessee Bank Tax Does Not Unconstitutionally Discriminate Against Obligations Of The United States.

The Appellant contends that discrimination occurs where the Bank Tax is imposed upon it in addition to other state franchise and excise taxes. However, it is well settled that where the legislative intent is clear, more than one privilege or excise tax may be exacted from a particular taxpayer. *Camden Fire Ins. Assoc.* v. *Haston*, 284 S.W. 905 (Tenn. 1926); *Foster & Creighton Co.* v. *Graham*, 285 S.W. 570 (Tenn. 1926); and, see, *Oliver* v. *King*, 612 S.W. 2d 152 (Tenn. 1981). The power to tax

privileges is subject to the constitutional limitation that the tax must not be discriminatory, i.e., arbitrary, capricious, or wholly unreasonable. *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522 (1959); *Hooten* v. *Carson*, 209 S.W.2d 273, 274 (Tenn. 1948); *Bank of Commerce* v. *Senter, supra.*

The state legislature may impose special burdens upon defined classes in order to achieve permissible ends, so long as there is some relevance to the purpose for which the classification is made. *Genesco, Inc.* v. *Woods*, 578 S.W.2d 639, 641 (Tenn. 1975). Clearly, by the very nature of the business they pursue, banks enjoy many corporate privileges beyond those enjoyed by other corporate entities. Because there is no evidence of arbitrary, capricious, or irrational classification in the imposition of the excise sur-tax on banks, there is no prohibited discrimination.

It should also be pointed out, that banks in Tennessee are exempt from the Business Tax Act, *Tenn. Code Ann.* § 67-5801, *et seq.*, App. 11a, which is another privilege tax on corporations doing business in Tennessee in addition to the taxes imposed by §§ 67-2701, *et seq.*, and 67-2901, *et seq.*

The Appellant further contends that the formula of "net earnings" discriminates against federal obligations by failing to provide for their income deduction while simultaneously failing to include income from obligations of the State of Tennessee and its subdivisions. These Appellees agree that the discrimination prohibited by the Exemption Statute would preclude an arbitrary levy intended to single out for taxation only those entities whose earnings are derived from federal obligations; but this is not the case in Tennessee.

The Tennessee tax is imposed by *Tenn. Code Ann.* § 67-751, which provides:

> There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject.

However, nowhere in the Bank Tax itself is there any definition or formulation of "net earnings." This figure must be computed as it would be for purposes of the State Excise Tax, which provides at *Tenn. Code Ann.* § 67-2704:

> The term "net earnings" is defined as federal taxable income before the operating loss deduction and special deductions provided for in §§ 241 through 247 and 249 through 250 of the Internal Revenue Code as

required to be reported by corporations under the Internal Revenue Code, subject to the following adjustments:

(a) There shall be added to the federal taxable income:

(1) Excise tax imposed by this state to the extent deducted in determining federal taxable income.

(2) Interest income earned on bonds and other obligations of other states or their political subdivisions less allowable amortization.

(3) Any deduction made pursuant to §§ 611-617 of the Internal Revenue Code to the extent the deduction when added with similar deductions in prior years exceeds the cost of the property.

(4) Gains not recognized pursuant to § 337 of the Internal Revenue Code.

(5) The charitable contributions deduction claimed under § 170 of the Internal Revenue Code.

(6) Any capital loss carrybacks or carryovers deducted pursuant to § 1212(a) of the Internal Revenue Code.

(b) There shall be subtracted from the federal taxable income:

(1) Dividends earned by a parent corporation from a subsidiary corporation where such parent owns eighty percent (80%) or more of the stock of the subsidiary.

(2) Any amount included in federal taxable income but not taxable under the law of this state.

(3) Any net operating loss incurred, which is defined as the excess of allowable deductions over total income allowable to this state for the year of the loss, and which may be carried over and allowed in succeeding tax years until fully utilized in the next succeeding taxable year or years in which

the taxpayer has net income, but in no case for more than three (3) years after the taxable year in which the net operating loss occurs.

(4) A portion of the gain or loss on the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis.

(5) Actual charitable contributions made by the corporation during the fiscal year.

(6) Losses not deducted pursuant to § 337 of the Internal Revenue Code.

(7) Any capital losses incurred during the fiscal year and not deductible under § 1211(a) of the Internal Revenue Code.

(8) Any expense, other income taxes, not deducted in determining federal taxable income for which a credit against the federal income tax is allowable. This subdivision shall apply to taxable periods ending on and after December 31, 1977.

Therefore, it is apparent that the Tennessee Bank Tax Act does not single out federal obligations for taxation and includes all obligations in the measure of the tax except obligations of the State of Tennessee and its subdivisions. This does not amount to unconstitutional discrimination against federal obligations. This Court has ruled that the states have a wide range of discretion in making classifications for purposes of taxation. *Lehnhausen* v. *Lakeshore Auto Parts Company*, 410 U.S. 356 (1973).

To elucidate the meaning of "nondiscriminatory" as used in 12 U.S.C. § 742, it is helpful to review decisions of this Court, bearing in mind whether in each case the tax imposed was a property or income tax as opposed to a

privilege or excise tax. In an early and frequently cited case, this Court stated:

> Nothing can be more certain in legal decision than that the privileges and franchises of a private corporation, all trades and avocations by which the citizens acquire a livelihood, may be taxed by a state for the support of the state government. Authority to that effect resides in the state independent of the Federal Government, and is wholly unaffected by the fact that the corporation or individual has or has not made investment in Federal Securities.

Society for Savings v. *Coite*, 6 Wall. 594, 606 (1867). There, a privilege tax upon the total amount of deposits was sustained, even though $500,000.00 of the deposits had been invested in securities of the United States, and declared by Congress to be exempt from taxation by state authority.

In the landmark opinion of *Flint* v. *Stone Tracy Co.*, *supra*, Congress' power to levy an excise on corporations and insurance companies, measured by net income, was upheld. The insurance companies and banks contended that the tax measured by income derived in part from investments in federal, state, or municipal bonds was void because it reached property not subject to taxation. This Court responded, 220 U.S. at 162:

> But this argument confuses the measure of the tax upon the privilege with direct taxation of the state or thing taxed.

This Court went on, 220 U.S. at 165:

> It is therefore well settled by the decisions of this Court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation as an exercise of a franchise or privilege, *it is no objection that the measure of taxation is found in the*

> *income produced in part from property which of itself considered is non-taxable.* (Emphasis added.)

The taxpayers contended that measurement of the tax by net income was unequal, arbitrary, and baseless, i.e., discriminatory. To this challenge, this Court replied that "the tax must be measured by some standard, and none can be chosen which will operate with absolute justice and equality." *Id.*

Moreover, the definition of "discrimination" advanced by the Appellant is wholly inconsistent with the facts of *Flint* v. *Stone Tracy Co., supra;* the measure of net income there included an express deduction for income from corporate securities but no deduction for tax exempt security income.

Discrimination was condemned in *Miller* v. *Milwaukee*, 272 U.S. 713 (1927). In this case, the Wisconsin income tax scheme sought to impose a prohibited income tax on federal bonds in the hands of the corporation by following the exempt income and taxing it in the hands of the stockholders. In condemning the tax, this Court stated, 272 U.S. at 715:

> If the avowed purpose or self-evident operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail. . . . we think it would be going too far to say that they allow intentional interference that is only prevented from being direct by the artificial distinction between a corporation and its members. *A tax may very well be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but it becomes a more serious attack on their immunity when they are its obvious aim.* (Emphasis added.)

This rationale was next applied to the Massachusetts Business Corporation Excise Tax. This Court found, based upon the legislative history, that the enactment was a deliberate, intentional scheme to lay a tax upon non-taxable bonds by deceptively using the word "excise." *Macallen Company* v. *Massachusetts*, 279 U.S. 620, 633 (1929). The controlling principle was that the state could not tax United States bonds or income directly or indirectly—"that is to say, it cannot tax *them* in any form." 279 U.S. at 629. (Emphasis in original.) This Court concluded that the Act "in substance and effect imposes a tax upon federal bonds and securities," 279 U.S. at 634, and held it void. This is the only instance of which these Appellees are aware where this Court has invalidated a so-called excise tax on the grounds that it discriminated against federal obligations.

The Appellant relies upon *Missouri ex rel. Missouri Insurance Company* v. *Gehner*, 281 U.S. 313 (1930). However, that case stands only for the accepted proposition that in imposing *a property tax*, the state may not subject federal securities to the burden of the tax.

In *Educational Films Corp.* v. *Ward*, *supra*, the substantive distinction between a tax *upon* federal securities or their income and a permissible state franchise tax was reaffirmed, 282 U.S. at 389:

> While this Court, since *McCulloch* v. *Maryland*, has consistently held that the instrumentalities of either government, or the income derived from them, may not be made the direct object of taxation by the other (citations omitted), it has held with like consistency that the privilege of exercising the corporate franchise is no less an appropriate object of taxation by one government merely because the corporate property or net income, which is made the measure of the tax, may chance to include the obligations of the

> other, or the income derived from them. The constitutional power of one government to reach this permissible object of taxation may not be curtailed because of the indirect effect which the tax may have upon the other.

This distinction was again pointed out in *Pacific Co.* v. *Johnson*, 285 U.S. 480 (1932). In responding to the contention that the California franchise tax was discriminatory, this Court referred to *Miller* v. *Milwaukee*, *supra*, noting that "it was the exclusion from the measure of the tax of *all* income except from federal bonds which rendered the tax invalid." 285 U.S. at 493. (Emphasis added.) "But the present case is not one of discrimination. There is no attempt . . . to measure the tax by exempt income while excluding from the measure all taxable income." 285 U.S. at 493-494.

In the instant case, the Appellant also relies upon *Schuylkill Trust Company* v. *Commonwealth*, 296 U.S. 113 (1935). The subject of the tax was *property*, not an excise or franchise. The facts were very similar to those considered in *Miller* v. *Milwaukee*, *supra*, and this Court applied identical reasoning, 296 U.S. at 120:

> We think that the issue of discrimination is not to be resolved by a choice between the two contentions as to the nature of the tax [whether a tax upon corporate assets or a tax upon shares of corporate stock] . . . if to measure the shareholder's tax by inclusion of these taxed or exempted securities found amongst the company's assets would be to tax the shareholder in virtue of those securities, it seems clear that to refuse to except United States securities from the measure of the tax is to lay a tax reckoned upon their value.

This is nothing but a restatement of the *Miller* rule, not a new definition of "discrimination" as contended by the Appellant.

In *Tradesmens National Bank* v. *Oklahoma Tax Commission*, 309 U.S. 560 (1940), a tax upon every national banking association located or doing business within the state according to or measured by its net income at a rate of 6 percent was validated. The Bank had alleged that the Act was discriminatory, relying upon *Macallen Company* v. *Massachusetts, supra.* This Court reiterated the true rule of *Macallen*, 309 U.S. at 566:

> Thus the legislative abandonment of a policy which had previously discriminated in favor of tax-exempt securities was treated as a discrimination against them, and the tax, although in fact nondiscriminatory, was condemned as analoguous to the discriminatory tax held invalid in the Miller Case. (citations omitted) It cannot be said that the Oklahoma tax in question here was *aimed* at tax exempt federal securities in the manner thus disclosed and condemned in the Macallen Company Case. (Emphasis added.)

Thus emerges the true definition of "discrimination." In the context of a property tax, as one levied upon corporate shares, discrimination occurs because the tax is aimed at and directly assessed against the federal obligations or their income. Discrimination occurs in an excise tax when the tax, though disguised as an excise, is specifically aimed at and actually does impose a direct tax on the federal securities, in an effort to circumvent the prohibition against direct taxation; hence, the tax is not a *bona fide* excise. This interpretation is entirely consistent with the excise tax validated in *Flint* v. *Stone Tracy Co., supra:* the tax was truly an excise, and was upheld despite the deduction of corporate security income with the inclusion of government obligation income in the calculation. Compare, *Woodland Production Credit Association* v. *Franchise Tax Board*, 37 Cal.Rptr. 231 (Cal. App. 1964), upholding an excise tax measured by income, even

though the taxpayer's entire income was derived from United States Bonds.

At the risk of repetition, these Appellees again cite to this Court the plain language of *Miller* v. *Milwaukee*, *supra*, 272 U.S. at 715:

> A tax may very well be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but it becomes a more serious attack on their immunity when they are its obvious aim.

It cannot be reasonably argued that the Tennessee Bank Tax is aimed at federal obligations. There also can be no doubt as to the intent of the Tennessee Legislature when it enacted *Tenn. Code Ann.* § 67-751. The Legislative Committee found that the existing taxing scheme imposed an excessive burden on banks and the sole purpose of the proposed legislation was to provide a more equitable taxing scheme for banks (J.A. 57a-60a).

This Court has not had an opportunity since the 1959 Amendment to interpret the meaning of "nondiscriminatory" contained in 31 U.S.C. § 742 and the cases cited by the Appellant do not sustain its definition of "nondiscriminatory," i.e., a tax statute discriminates against obligations of the United States where it imposes a higher tax on taxpayers who hold federal obligations than on those who hold other assets. To follow Appellant's definition to a logical conclusion, this Court must rule that the exclusion by the state of any obligations from the tax base without excluding obligations of the United States is discriminatory. As stated by Justice Cardozo in his dissenting opinion in *Schuylkill Trust Company* v. *Commonwealth*, *supra*, 296 U.S. at 129, 130:

> "To hold that there was discrimination here in any forbidden sense is to hold that bonds and notes of the

> United States must be deducted from the value of the shares if there is a deduction of any form of investment, no matter how minute in amount or alien in quality . . . discrimination . . . must be so marked as to justify the inference that it was unfriendly in design or at the very least it must favor forms of investment that are in substantial competition with government securities."

In *Mercantile Nat. Bank* v. *New York*, 121 U.S. 138 (1887), this Court ruled that the exclusion of municipal bonds of the City of New York while not excluding shares of stock in national banks, did not invalidate the taxing statute in question. Also, see *South Broadway Nat. Bank* v. *City and County of Denver*, 51 F.2d 703 (10th Cir. 1931), wherein the court ruled that the exclusion of state and municipal bonds from the tax did not amount to discrimination.

The Appellant contends that the Tennessee Bank Tax will obstruct the borrowing power of the United States by making state and municipal obligations more attractive than federal obligations. However, it should be pointed out that the tax in question applies only to banks and there is absolutely no evidence in the record that the tax in question would in any way make obligations of the United States less attractive than obligations of Tennessee and its subdivisions or that obligations of Tennessee and its subdivisions compete substantially with obligations of the United States.

Congress apparently was not concerned about the competition with state and municipal securities when it excluded such securities from the Internal Revenue Act while making federal securities taxable. 26 U.S.C. § 103, App. 13a. It is submitted that the policy of Congress has always been to foster and encourage investments in state and municipal securities. In *Drew* v. *United States*, 394

F.Supp. 340 (Tex. 1975), affirmed 551 F.2d 85 (5th Cir. 1977), the court stated at 342 as follows:

> . . . The rationale arises from the fact that the purpose of § 103, which has survived since the first internal revenue laws in 1919, was (a) to relieve states and municipalities from the burden upon their power to borrow money which taxation of interest would impose and (b) to encourage investors to put their resources into what might, without tax-free interest, be unattractive investments in state and local governments. . . ."

Also, see *Holley* v. *United States*, 124 F.2d 909 (6th Cir. 1942), *cert. denied* 316 U.S. 685.

It cannot be assumed that obligations of the United States would be less attractive to banks than state or municipal obligations merely because their income is included in calculation of the three percent (3%) Tennessee Bank Tax. The Bank Tax may not be significant enough to deter investors, especially since the credit of the United States is one of the main features of its obligations. It is apparent that many factors influence the attractiveness of investments and it was incumbent upon the Appellant to offer some evidence in the trial court that the Tennessee Bank Tax would adversely affect obligations of the United States and that the state obligations in question were in substantial competition with the federal obligations in question; however, none was offered. The record is completely silent in this regard and the Court cannot take judicial notice of these facts, especially in view of the fluctuating nature of the securities market.

II.

THE TENNESSEE BANK TAX DOES NOT VIOLATE 12 U.S.C. §§ 2055, 2079 and 2134.

In addition to the aforementioned reasons why the Tennessee Bank Tax does not unconstitutionally discriminate against obligations of the United States, these Appellees would further show that none of the Farm Credit System statutes prohibit a state from including obligation income in measuring corporate excise taxes imposed by the state. The Tennessee Bank Tax simply does not tax the assets of the Farm Credit System banks located in the state, nor does it tax their securities.

The reason for the exemption given to the United States Treasury notes and bonds is absent in the case of the Farm Credit System banks. To allow a state to tax Treasury notes and bonds would impede the power of Congress to borrow money on the credit of the United States as authorized by Article 1, § 8 of the United States Constitution. However, the United States is not liable on the bonds or notes issued by the Farm Credit System Banks. These banks are, essentially, privately owned corporations. The banks themselves are responsible for and are fully liable on their notes or other obligations:

> 12 U.S.C. § 2155 Liability of banks/ United States not liable—
>
> (a) Each bank of the System shall be fully liable on notes, bonds, debentures, or other obligations issued by it individually, . . .
>
> (c) The United States shall not be liable or assume any liability directly or indirectly thereon.

Clearly, then, a state does not impair the power of the United States to borrow money in these cases where the notes, bonds, and other obligations issued by the Farm

Credit System Banks are *not* issued on the credit of the United States. Arguably, where these federal instrumentalities are privately owned, their personal property should be taxable by the state and local governments where the property has its situs. However, this question has not yet been resolved by this Court. *See, e.g.*, Antieau, *Modern Constitutional Law* § 10:79.

III.

THE TENNESSEE BANK TAX IS NOT UNCONSTITUTIONAL AS APPLIED TO APPELLANT.

A close review of the pleadings reveals that Appellant has walked a technical tightrope on the issue of constitutionality of the Tennessee Bank Tax. On the one hand, Appellant has contended that the Tennessee Act directly violates the Federal Exemption Statute, thus being unconstitutional under the Supremacy Clause, Article VI, United States Constitution. However, Appellant has simultaneously argued below that the Tennessee Act is not unconstitutional, but is merely being unconstitutionally "applied" to it.

The Appellant has not shown that the Tennessee statute is applied to it any differently than it is applied to all banks in the state. Moreover, the Appellant has failed to advance any valid theory under which any portion of the Bank Tax could be exorcised. This is because the Bank Tax itself does not establish the formula for calculation of "net earnings." *Tenn. Code Ann.* § 67-751 simply provides that "the net earnings shall be calculated in the same manner as prescribed by *Tenn. Code Ann.* § 67-2701, *et seq.*

The Appellant has relied upon Chapter 40, Section 9 of the Tennessee Public Acts of 1977 for the proposition that any unconstitutional or invalid portion of the Tennessee

statute may be severed and the remaining portions preserved:

> If any provisions of this act or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of this act which can be given effect without the invalid provision or application, and to that end, the provisions of this act are declared to be severable.

In *Tenn. Code Ann.* § 67-756, the Legislature assigned the duty of administering the Bank Tax to the Division of Property Assessments. However, that Division does not calculate "net earnings." *Tenn. Code Ann.* § 67-758 requires the State Commissioner of Revenue to certify to the Director of the Division of Property Assessments the "net earnings" for each bank. This "net earnings" figure certified by the Commissioner of Revenue is the same figure which must be calculated under *Tenn. Code Ann.* § 67-2704, the statute which sets out the "net earnings" for purposes of the Excise Tax.

In other words, the Bank Tax requires the Commissioner of Revenue to certify to the Division of Property Assessments that identical "net earnings" figure which is calculated for the Excise Tax. Because the allegedly offending calculation is mandated by the Excise Tax "net earnings" formula, there is absolutely no way that this formula can be severed from the statute to the extent that it may be constitutional.

In argument presented to the trial court, Appellant relied upon *Montana Bankers' Association* v. *Montana Department of Revenue*, 580 P.2d 909 (Mont. 1978). In that case, the Montana court reached a conclusion diametrically opposed to the result in the *Bank of Texas* case. However, the *Montana Bankers'* case presented quite a different factual setting from the instant case. In

Montana, the Legislature had enacted not only a statute establishing the Bank Tax, but the Montana Department of Revenue had then enacted implementing provisions of the Montana Administrative Code. The Montana bankers had petitioned the Montana Department of Revenue for an amendment of the Administrative Code to provide specifically for a deduction of the value of United States Government obligations held by Montana banks in computing the value of bank shares for assessment purposes. No similar administrative remedy is available in Tennessee.

It is submitted that this Court cannot promulgate administrative rules for calculation of "net earnings," nor can this Court rewrite the Tennessee statute to compel the Commissioner of Revenue to compute one "net earnings" figure for purposes of the Tennessee Excise Tax and then compute a second "net earnings" figure for purposes of the Bank Tax.

It was the position of these Appellees in the trial court and in the Supreme Court of Tennessee that the Tennessee Bank Tax is constitutional, under both 12 U.S.C. § 548 and 31 U.S.C. § 742. These Appellees took the alternative position that if the Tennessee Bank Tax is unconstitutional under either or both of said sections, then the pre-1977 Bank Tax, *Tenn. Code Ann.* § 67-715, *et seq.* (1976), is revived.

However, since the Supreme Court of Tennessee upheld the Bank Tax as a nondiscriminatory franchise tax, the state tribunal did not reach the issue of whether, on the one hand, federal interest income could be carved out of the "net earnings" figure by administrative manipulation, thus preserving the remainder of the statute, or whether, on the other hand, the Act would be void in its entirety, thus triggering revival of the pre-1977 Bank

Tax under Tennessee law. In the event that this Court concludes that interest income from federal obligations cannot constitutionally be included in the measure of "net earnings" upon which the Tennessee tax is computed, then these Appellees respectfully request that this Court decline to reach the question of whether the state statute can otherwise be salvaged, by remanding the case to the Supreme Court of Tennessee for determination of that question under the Constitution and statutes of the State of Tennessee.

CONCLUSION

WHEREFORE, AND FOR ALL OF WHICH, these Appellees request that the judgment of the Supreme Court of Tennessee be affirmed and the Appellant's appeal be dismissed.

Respectfully submitted,

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§ 742. Exemption from taxation

Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

R.S. § 3701; Sept 22, 1959, Pub.L. 86-346, Title I, § 105(a), 73 Stat. 622.

NATIONAL BANK SHARES

§ 548. State taxation

The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are compiled with:

1. (a) The imposition by any State of any one of the above four forms of taxation shall be in lieu of the others, except as hereinafter provided in subdivision (c) of this clause.

(b) In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks: *Provided*, That bonds, notes, or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section.

(c) In case of a tax on or according to or measured by the net income of an association, the taxing State may, except in case of a tax on net income, include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing business within its limits: *Provided, however*, That a State which imposes a tax on or according to or measured by the net income of, or a franchise or excise tax on, financial, mercantile, manufacturing, and business corporations organized under its own laws or laws of other States and also imposes a tax upon the income of individuals, may include in such individual income dividends from national banking associations located within the State on condition that it also includes

dividends from domestic corporations and may likewise include dividends from national banking associations located without the State on condition that it also includes dividends from foreign corporations, but at no higher rate than is imposed on dividends from such other corporations.

(d) In case the dividends derived from the said shares are taxed, the tax shall not be at a greater rate than is assessed upon the net income from other moneyed capital.

2. The shares of any national banking association owned by nonresidents of any State shall be taxed by the taxing district or by the State where the association is located and not elsewhere; and such association shall make return of such shares and pay the tax thereon as agent of such nonresident shareholders.

3. Nothing herein shall be construed to exempt the real property of associations from taxation in any State or in any subdivision thereof, to the same extent, according to its value, as other real property is taxed.

4. The provisions of section 5219 of the Revised Statutes of the United States as in force prior to March 25, 1926, shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section. R.S. § 5219; Mar. 4, 1923, c.267, 42 Stat. 1499; Mar. 25, 1926, c.88, 44 Stat. 223.

§ 548. State taxation

For the purpose of any tax enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located.

As amended Dec. 24, 1969, Pub.L. 91-156, §§ 1(a), 2(a), 83 Stat. 434.

BANK TAX

67-751. Excise tax on bank earnings—Rate. There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescibed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject. [Acts 1977, ch. 140, § 1.]

67-752. Minimum tax. —In no event shall the tax imposed under § 67-751 upon any bank be less than an ad valorem tax calculated on the basis of sixty percent (60%) of the book value of the bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits.

In determining the value to be assessed, the following shall be deducted from the sixty percent (60%) book value:

(1) The appraised value of all real property and tangible personal property otherwise owned and assessed to companies subject to this tax; and

(2) The appraised value of all real property in Tennessee occupied by companies subject to this tax and used for the purpose of conducting their business under a lease which provides that all ad valorem taxes on such property shall be paid by such companies and said lease has been registered in the county where such property is located.

The remaining value shall be assessed at forty percent (40%) and the resulting assessment shall be the amount to which the appropriate city and county tax rates shall be applied to determine the tax due and payable to the respective taxing jurisdictions. [Acts 1977, ch. 140, § 1.]

67-753. New banks. —The tax of any bank which has been in business less than five (5) years shall be reduced proportionately at the rate of one fifth (1/5) for each year less than five (5) it has been in business. [Acts 1977, ch. 140 § 1.]

67-754. Allocation of tax. —Unless the tax imposed herein shall be calculated under § 67-752, the total tax shall be allocated between the county and municipality where the principal office of the bank is located in the same proportion as the property tax rate of each taxing jurisdiction for the immediately preceding year shall bear to the sum of said property tax rates of both taxing jurisdictions; except that in those counties having populations of not less than 125,000 nor more than 140,000 according to the U.S. census population of 1970 or any subsequent federal census of population allocation shall further be determined in the following manner:

In those circumstances where a bank has branches or offices in municipalities other than the municipality where its principal office is maintained, but within the same county as its

principal office, the total taxes due under §§ 67-751—67-763 shall be allocated between such county and such municipalities where its principal office and branches are located as follows:

(1) The percentage produced by the ratio of the deposits of each branch or office to the total deposits of the bank shall be determined as of January 1 of each year;

(2) The percentage so determined shall then be applied to the total tax calculated to be due under § 67-751 to determine the portion of the total taxes attributable to each branch or office;

(3) The branches or offices, including the principal office, shall then be grouped each to a common location so as to determine the aggregate taxes of all branches or offices located in each individual municipality within such county, and the total taxes allowable to each such common location shall then be divided between the county and each municipality in which such branches or offices are maintained in the same proportion as the property tax rate of each for the immediately preceding year shall bear to the total of the said property tax rates; or

(4) The percentage of the deposits of each branch or office as determined under subdivision (1) above shall be applied to total assessment resulting from calculations under § 67-752 to determine the portion of the total assessment attributable to each branch or office; and

(5) The branches or offices, including the principal office, shall then be grouped each to a common location so as to determine the aggregate portion of the assessment of all branches or offices located in each individual municipality within such county to which the appropriate county and municipal tax rates applicable in each such municipality shall be applied to determine the tax due and payable to the respective taxing jurisdictions. [Acts 1977, ch. 140, § 1; 1979, ch. 255, § 1.]

67-755. Banks having branches in two or more counties. —In circumstances where a bank has branches or offices in a county or counties other than the county where its principal

office is maintained, the total taxes due under §§ 67-751—67-763 shall be allocated between such counties and municipalities where its principal office and branches or offices are located as follows:

(1) The percentage produced by the ratio of each branch's or office's deposits to the total deposits of the bank shall be determined as of January 1 of each year and the percentage so determined shall then be applied to the total tax due to determine the portion of the total taxes attributable to each bank or office;

(2) The branches or offices shall then be grouped each to a common location so as to determine the aggregate taxes of all branches or offices located in each individual county and municipality; and

(3) The percentage of the total taxes allowable to each county and municipality shall then be divided between the county and municipality in which the branch or office is maintained in the same proportion as the property taxes of each for the immediately preceding year shall bear to the total of the said property tax rates of each. [Acts 1977, ch. 140, § 1.]

67-756. Administration of tax. —The administration of the tax imposed by §§ 67-751—67-763 shall be the duty of the division of property assessments of the state of Tennessee. The division shall have authority and power to prescribe forms upon which all banks shall make reports of such facts and information as will enable the division to ascertain the correctness of the taxes to be paid. By July 1, or as soon thereafter as possible, the division of property assessments shall furnish to each bank a form, approved by the state board of equalization, to report its net earnings to said division on or before September 1 of each year.

After making the allocation required in § 67-754 on or before November 1 of each year, the division of property assessments shall certify to the chief executive officer, county trustee, municipal treasurer, or other official responsible for collecting

the taxes due under §§ 67-751—67-763 the amount of taxes due from each bank subject to §§ 67-751—67-763.

In the event that any bank subject to the provisions of this act fails, refuses, or neglects to complete and file such form with the division of property assessments as above provided, the division of property assessments shall make a forced assessment of the amount of tax due from such bank on the basis of the best information available and shall give certification of same to the proper county and municipal officials with a copy to the chief official of said bank. Said notification shall be sent by United States mail, addressed to the last known address of the taxpayer and shall be effective when mailed.

In the event the division of property assessments shall fail to complete any assessment or notify any taxpayer by the dates provided herein, such failure shall not affect, in any way, the validity of such assessment; provided that an aggrieved taxpayer shall have the right to appeal to the state board of equalization at its next regular session. [Acts 1977, ch. 140, § 1; 1979, ch. 158 § 1.]

67-757. Division of property assessments' powers in obtaining evidence. —The division of property assessments shall have full power to summon witnesses, to inspect or require the production of books and papers, and to obtain and consider any evidence other than the reports submitted by such company, which it may deem proper or necessary. [Acts 1977, ch. 140, § 1.]

67-758. Commissioner to certify net earnings. —On or before August 1 of each year the commissioner of revenue shall certify to the director of the division of property assessments the net earnings for each bank doing business in the state as determined pursuant to chapter 27 of title 67.

In the event that the net earnings of any bank subject to §§ 67-751—67-763 shall be finally redetermined for any period in accordance with chapter 27 of title 67, it shall be the duty of

the commissioner of the department of revenue to certify the correct net earnings to the division of property assessments within thirty (30) calendar days after such final redetermination; the division of property assessments shall then have the duty to reassess the amount of tax owed for said period in accordance with the provisions and formulas set forth in §§ 67-751—67-763 and to certify to the county trustee, municipal treasurer, or other official responsible for collecting the tax the amount of any increase in the tax due or the amount of any refund. [Acts 1977, ch. 140, § 1.]

67-759. Collection. —It shall be the duty of the county trustee, municipal treasurer or other official responsible for collecting the ad valorem taxes to collect the amount of tax imposed by §§ 67-751—67-763. Such collection shall be in accordance with §§ 67-1101—67-1122 and any other sections of this Code or any applicable municipal charter relating to the collection and payment of ad valorem county or municipal taxes. [Acts 1977, ch. 140, § 1.]

67-760. Payment of tax. —For the purpose of collecting such taxes, and in addition to any other laws of this state relative to the imposition and collection of taxes, it shall be the duty of each bank to pay the taxes due under §§ 67-751—67-763, a prior lien being declared on all corporate property of such bank as of the first day of January of each year. [Acts 1977, ch. 140, § 1.]

67-761. Attachment of corporate property. —If the taxes shall not be paid by any bank subject to §§ 67-751—67-763, then the state, county or municipality may, after such tax may have become delinquent, proceed to collect the same by attachment on its corporate property in any court of competent jurisdiction, through counsel to be employed for that purpose. [Acts 1977, ch. 140, § 1.]

67-762. Administrative review. —Any bank which is aggrieved by any determination of the division of property

assessments shall have the right to make a complaint or an appeal directly to the state board of equalization. All complaints and appeals shall be filed with the executive secretary of said board on or before August 1 of the year in which the appeal is prosecuted, unless such appeal results from an action of the division of property assessments subsequent to July 1 next preceding. In such circumstances any complaints and appeals shall be filed with the executive secretary of said board within thirty (30) days following receipt of notification of such action by the division of property assessments. [Acts 1977, ch. 140, § 1.]

67-763. Rules and regulations. —The state board of equalization through the division of property assessments shall be charged with the implementation of §§ 67-751—67-762 and shall promote all necessary rules, regulations, instructions and procedures for its implementation. [Acts 1977, ch. 140, § 1.]

BUSINESS TAX

67-5801. BUSINESS TAX ACT—SCOPE.—

This chapter shall be known as the Business Tax Act and the taxes imposed by this chapter shall be in addition to all other privilege taxes. It is the legislative intent that the taxes imposed by this chapter shall be in lieu of any or all ad valorem taxes on the inventories of merchandise held for sale or exchange by persons taxable under this chapter, from and after January 1, 1973 or such other time as said in lieu of tax may be constitutionally validated. [Acts 1971, ch. 387, § 1; 1972 (Adj. S.), ch. 850, § 1.]

67-5802. PRIVILEGES AFFECTED FOR LOCAL TAXATION.—

Subject to the requirements set forth in §§ 67-5823—67-5826 relative to the amount of tax required to be forwarded to the state, the making of sales by engaging in any vocation, occupation, business or business activity enumerated, described or referred to in § 67-5805, classification 1, classification 2, and classification 3 is declared to be a privilege upon which each county and/or incorporated municipality in which said business, business activity, vocation, or occupation is carried on may levy a privilege tax in an amount not to exceed the rates hereinafter fixed and provided. . . .

67-5805. CLASSIFICATIONS.—

Businesses, vocations and occupations which are taxable are set forth in the following classifications: Provided, however, that each person shall be classified according to the dominant business activity. . . .

Classification 3.

(k) . . . Each person making sales or services or engaging in the business of furnishing or rendering services, except those described below. . . .

(10) Services furnished by institutions which are engaged in deposit banking or closely related functions including fiduciary activities, services furnished by persons engaged in extending credit or lending money except persons taxable under classification 5 of this section; services furnished by establishments engaged in the underwriting, purchase, sale, or brokerage of securities on their own account or on the account of others; services furnished by exchanges, exchange clearing houses and other services allied with the exchange of securities and commodities; services furnished by investment trusts, investment companies, holding companies, and commodity trading companies. . . .

§ 103. INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

(a) General rule.—Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia;

(2) the obligations of the United States; or

(3) the obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

(b) Exception.—Subsection (a)(2) shall not apply to interest on obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit to the extent they represent deposits made before March 1, 1941), unless under the respective Acts authorizing the issuance thereof such interest is wholly exempt from the taxes imposed by this subtitle.

Section 103 was amended in 1976 and now provides as follows:

§ 103. INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

(a) General rule.—Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia; and

(2) qualified scholarship funding bonds.

Appellee's Brief

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No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,
Appellees.

On Appeal From The Supreme Court of Tennessee

BRIEF OF APPELLEE, WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE

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COUNTER-STATEMENT OF QUESTION PRESENTED

Whether the state court correctly held that 31 U.S.C. § 742 and 12 U.S.C. §§ 2055, 2079 and 2134 do not prohibit the imposition of a local excise tax levied on banks doing business in Tennessee when the measure of said bank tax is federal taxable income which incidentally includes, among other items of income, interest on federal obligations and interest on the obligations of federal agencies.

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No. 81-1613

IN THE

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OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,
and
GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,
and
WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,
Appellees.

On Appeal From The Supreme Court of Tennessee

BRIEF OF APPELLEE, WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE

STATEMENT OF THE CASE

On June 27, 1979, the Appellant filed its complaint in the Chancery Court for Shelby County, Tennessee, to recover bank taxes paid under protest for the years 1977 and 1978. (J.A. 8a-12a). The Appellant alleged that T.C.A. § 67-751 (Appendix pg. A-1) was an intangible personal property tax and that said

tax was computed on the basis of the Appellant's "net earnings" which were defined in T.C.A. § 67-2704 (Appendix pg. A-7-A-10) as "federal taxable income." The Plaintiff alleged that since income from "United States obligations" is included in federal taxable income, the bank tax was in violation of the exemption provision of 31 U.S.C. § 742 and unconstitutional under the provisions of the Supremacy Clause in the United States Constitution.

The Appellant amended its complaint alleging that a portion of the "net earnings" subject to tax was exempt interest from "obligations of the United States" and that these obligations consisted of United States Treasury notes and Treasury bills, and interest on obligations of United States agencies including Federal Land Banks, Federal Intermediate Credit Banks and Banks for Cooperatives. The Appellant further alleged that all of these obligations are "United States obligations" and, thus, expressly exempted from State, municipal or local taxation by 31 U.S.C. § 742, because said Section prohibits the inclusion of such obligations or the interest therefrom in the calculation of the tax levied by T.C.A. § 67-751. The Appellant also plead that the Farm Credit Bank notes and bonds were excluded from the computation of the bank tax by 12 U.S.C. §§ 2055, 2079 and 2134. The Appellant plead, in the alternative, that T.C.A. § 67-751 was in conflict with 31 U.S.C. § 742 and unconstitutional as applied since its computation had included the income in question or that said act was unconstitutionally in violation of 31 U.S.C. § 742 and void under the Supremacy Clause. (J.A. 27a-31a).

In the stipulation entered into by the parties it was stipulated that the interest earnings of the Appellant from "interest on obligations of the United States and U.S. instrumentalities" as reported on Line 5 of the Appellant's U.S. Corporate Income Tax Returns (see R. 18-19) for the tax years of 1977 and 1978 were composed of the following:

1977 Tax Year (Tax Base Year, 1976)

(a) $ 928,219 from U.S. Treasury Notes

(b) $ 216,984 from U.S. Treasury Bills

(c) $2,030,913 from various United States agencies as follows:

Federal Land Bank	$1,247,095
Federal Intermediate Credit Bank	546,904
Farmers Home Administration	88,576
Federal National Mortgage Assn.	148,338

Total: $3,176,116

1978 Tax Year (Tax Base Year, 1977)

(a) $ 804,262 from U.S. Treasury Notes

(b) $ 44,536 from U.S. Treasury Bills

(c) $2,726,869 from various United States agencies as follows:

Federal Land Bank	$1,625,602
Federal Intermediate Credit Bank	656,551
Banks for Cooperatives	265,000
Farmers Home Administration	88,365
Federal National Mortgage Assn.	91,351

Total: $3,575,667

(See J.A. 36a-38a).

The Appellant's net earnings employed in the calculation of the excise tax were:

Net Earnings for 1977 tax year - $1,389,522
Net Earnings for 1978 tax year - $1,505,424

(J.A. 36a-37a).

The Appellant's gross earnings were $13,728,460 for the 1977 tax year and $16,439,794 for the 1978 tax year. (R.74 and 84).

The gross earnings of Appellant as reported in Schedule J (R. 74 and 84) on its Tennessee Franchise & Excise Tax Returns (Exhibits to Stipulations found at R.71-87) consisted of interest on Bank deposits, notes, mortgages, bonds (Line 7 of Schedule J), profit from sale of real estate, stocks, bonds, etc. (Line 10, Schedule J), other income (Line 11, Schedule J) which was separately scheduled for the 1976 Return (see R.76). The 1976 Return showed interest on obligations of the State of Tennessee and its political subdivisions in the amount of $348,348 (Line 39, Schedule J). It was stipulated by the Appellant that interest from the Federal National Mortgage Association and Farmers Home Administration were properly includable in "net earnings" subject to the bank tax without violating 31 U.S.C. § 742.

Schedule D on Line 7 (R.72) of the Appellant's 1976 Tennessee Franchise & Excise Return shows that at the beginning of 1976 Appellant had $10,904,899 invested in "Obligations of Tennessee and its political subdivisions" and at year end had $16,577,948 invested in Tennessee bonds. Appellant's investment in other government obligations was $47,573,892 at the beginning of the year and $38,697,840 at year end.

Schedule D (R.82) for the 1977 Tennessee Franchise & Excise Tax Return indicates "Obligations of Tennessee and its political subdivisions" were essentially unchanged at $16,341,863 at year end, however, "Other Governmental Obligations" had sharply increased to $74,255,974 at year end.

It was further stipulated that if the interest from the United States Treasury Bills and Notes and from the bonds of Federal Land Banks, Federal Intermediate Credit Banks and Banks for Cooperatives were excluded from "net earnings" in each tax year, then the Appellant's "net earnings" on which the bank tax is levied would be less than zero and no tax would be owing under T.C.A. § 67-751 *et seq.* for either year. (J.A. 39a-40a).

The Shelby Chancery Court granted Memphis Bank & Trust's Motion for Summary Judgment and held that T.C.A. § 67-751 to the extent that it included "stocks, bonds, Treasury notes and other obligations of the United States" was in conflict with 31 U.S.C. § 742 and, thus, was unconstitutional as applied. (J.A. 61a-68a). The Court further adopted as part of its opinion that 12 U.S.C. §§ 2055, 2079 and 2134 also exempted the obligations in question and that under the Supremacy Clause they took precedence over the State's statute. (J.A. 67a).

In an independent examination of the nature of the excise tax on bank earnings, T.C.A. § 67-751, *Commerce Union Bank of Chattanooga* v. *State Bd. of Equalization,* 615 S.W.2d 151 (Tenn. 1981), the Tennessee Supreme Court found that this tax was a local excise tax imposed upon the exercise of the privilege of doing business in the corporate form in Tennessee.

On appeal to the Tennessee Supreme Court the Appellees herein relied upon the decision in *Commerce Union Bank of Chattanooga* v. *State Bd. of Equalization,* above, and argued that the excise tax on bank earnings, T.C.A. § 67-751, did not violate 31 U.S.C. § 742 because said tax was a non-discriminatory franchise tax expressly authorized by 31 U.S.C. § 742. Further, the Appellees herein argued that the cases of this Court have consistently upheld franchise taxes even though federal obligations or the interest thereon were included in the measure of such taxes. In the alternative, the Appellees herein argued that if the Court did not agree and found the tax unconstitutional, then the previous bank shares tax was revived and was constitutionally valid.

In its brief to the Tennessee Supreme Court, the Appellant herein for the first time raised the issues that the Tennessee Bank Tax discriminated against banks on the one hand and against federal obligations on the other.

The Tennessee Supreme Court reversed the decision of the trial court and held that the Tennessee Bank Tax clearly comes

within the exception provided in the second sentence of 31 U.S.C. § 742 and is not in conflict with the Farm Credit Banks exemption statutes. (J.A. 74a, 75a-81a). The Tennessee Supreme Court found that it is well established by prior cases of this Court that a corporate franchise created by the State can legitimately be taxed and that the tax may be imposed without any deduction for federal securities or interest thereon. The Court found in accordance with *Commerce Union Bank of Chattanooga* v. *State Bd. of Equalization, supra,* that the bank tax was a "nondiscriminatory franchise or other nonproperty tax in lieu thereof imposed on corporations" as authorized in 31 U.S.C. § 742. In response to the arguments of Appellant herein respecting discrimination, the Court found that (1) banks exercise a special privilege and, therefore, they may be separately classed and taxed differently from other corporations. Secondly, the Court concluded that the bank tax levied by T.C.A. § 67-751 does not single out U.S. obligations for special treatment and, accordingly, it is a nondiscriminatory franchise tax.

SUMMARY OF ARGUMENT

Under 31 U.S.C. § 742 as amended in 1959 the States have express authority to levy nondiscriminatory corporate franchise taxes which may include in their measure federal obligations or the interest thereon. The 1959 amendment was a codification of the decisions of this Court which have recognized that state franchise taxes may be imposed without any deduction for federal securities or the interest thereon.

The Tennessee Excise Tax on Bank Earnings, T.C.A. § 67-751, is a nondiscriminatory franchise tax. The nature of the bank excise tax is that it is a local excise tax measured by net earnings determined by the state excise tax and is levied on the exercise of the privilege of doing business in Tennessee. The tax is not a property tax.

Further, the Tennessee Excise Tax on Bank Earnings is nondiscriminatory. This tax does not single out federal obligations for special treatment in violation of *Miller* v. *Milwaukee, infra.* All items of taxable income including federal obligations are equally included in the measure of the tax. The exemption of Tennessee bonds is a legitimate exercise of the state's taxing power. Tennessee bonds are not in substantial competition with federal obligations and their exclusion does not impair the marketability of federal obligations. The Appellant has the affirmative burden of proof to establish any actual discrimination, however, the Appellant offered no proof on this issue.

The structure of the Tennessee Excise Tax on Bank Earnings is a legitimate exercise of the state's taxing power dealing with its domestic concerns and is not an infringement on the perogatives of the national government. Congress has manifested its intent with respect to bank taxation and the permissibility of including income from federal bonds in the measure of nondiscriminatory franchise taxes. The Tennessee Excise Tax on Bank Earnings is in accord with congressional intent and policy.

The inclusion of federal obligations and Farm Credit securities in the Tennessee Excise Tax on Bank Earnings is permissible under statutory authorization, 31 U.S.C. § 742, and under *Werner Machine Co.* v. *Director of Taxation, infra,* and similar decisions.

ARGUMENT

I. The Tennessee Excise Tax On Bank Earnings Is A Nondiscriminatory Franchise Tax As Authorized By 31 U.S.C. § 742.

Under 31 U.S.C. § 742 as amended in 1959 (Pub.L.No. 86-346, 73 Stat. 621) the States have express statutory authorization to levy nondiscriminatory corporate franchise taxes which may include in their measure federal obligations or the interest thereon. The 1959 Amendment to 31 U.S.C. § 742 was made to clarify but not make any substantive changes in the existing law. [*See* S.Rep. No. 909, 86th Cong., 1st Sess. (1959) reprinted in 1959 U.S. Code Cong. & Ad. News 2769, 2773-2774, 105 Cong. Rec. 18157, 18478-18479 (1959), Hearings on Public Debt Ceiling and Interest Rate Ceiling on Bonds, before the House Ways & Means Committee, 86th Cong., 1st Sess., 869-72 (1959)]. This amendment was a codification of the decisions of this Court which have established that a corporate franchise created by a state can legitimately be taxed and that the tax may be imposed without any deduction for federal securities or interest thereon. *Werner Machine Company* v. *Director of Div. of Taxation,* 350 U.S. 492 (1956); *Tradesmens National Bank of Oklahoma City* v. *Oklahoma Tax Commission,* 309 U.S. 560 (1940); *Pacific Company* v. *Johnson,* 285 U.S. 480 (1932); *Educational Films Corp. of America* v. *Ward,* 282 U.S. 379 (1931); *Flint* v. *Stone Tracy Company,* 220 U.S. 107 (1911).

In accord with 31 U.S.C. § 742 and prior case law, the Tennessee Excise Tax on Bank Earnings properly includes the interest from United States obligations and interest from bonds of Federal Land Banks, Federal Intermediate Credit Banks and Banks for Cooperatives in the measure of said tax. The bank excise tax is a nondiscriminatory franchise tax imposed upon the exercise of the corporate franchise in the State of Tennessee. *Commerce Union Bank of Chattanooga* v. *State Bd. of*

Equalization, 615 S.W.2d 151 (Tenn. 1981); *Memphis Bank & Trust Co.* v. *Garner,* 624 S.W.2d 551 (Tenn. 1981).

The Appellant seeks reversal of the judgment of the Tennessee Supreme Court and contends that the Excise Tax on Bank Earnings is not a franchise tax but a property tax and that even if the tax is a franchise tax, it is discriminatory and in violation of 31 U.S.C. § 742.

The Appellees contend that the Excise Tax on Bank Earnings, T.C.A. § 67-751, is a nondiscriminatory franchise tax as authorized in 31 U.S.C. § 742 and prior case law. Accordingly, the judgment of the Tennessee Supreme Court should be affirmed.

A. The Tennessee Bank Excise Tax is a Franchise Tax.

The nature of a tax must be determined by its operation rather than the descriptive language which may have been applied to it. *Educational Films Corp. of America* v. *Ward,* 282 U.S. 379, 387 (1931). Independently of the present case, the Tennessee Supreme Court examined the question of the nature of the Tennessee Bank Tax, T.C.A. § 67-751, in *Commerce Union Bank of Chattanooga* v. *State Bd. of Equalization,* 615 S.W.2d 151 (Tenn. 1981) and held that the tax was a local excise tax imposed on the exercise of the corporate franchise and was in addition to the state excise tax. In the court's analysis of this question, the court examined the operation of the tax and found that the bank tax is not a property tax but is an excise tax measured by corporate net earnings and is clearly so designated. 615 S.W.2d at 152.

The Tennessee Bank Tax, T.C.A. § 67-751, levies on each bank doing business in the State of Tennessee an excise tax of three percent (3%) of the net earnings of the corporation for the next preceeding year less a credit of ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next proceeding year. The "net earn-

ings" are calculated in the same manner as prescribed by the state corporate excise tax, T.C.A. § 67-2701 *et seq*. The state excise tax is levied on net earnings defined as "federal taxable income" subject to certain deductions and exemptions. T.C.A. § 67-2704.

The calculation of the Bank Tax is in accordance with the state excise tax and the rules and regulations which pertain to that tax. Under T.C.A. § 67-758, the Commissioner of Revenue, who collects and administers the state excise tax, is required to certify to the Director of the Division of Property Assessments the net earnings of each bank doing business in the State of Tennessee as determined pursuant to the state corporate excise tax. On the basis of the net earnings so certified, the Bank Tax is determined subject to the designated credits.

This Court has consistently held that the privileges and franchises of private corporations are legitimate subjects of taxation within the taxing powers of the states. *Hamilton Co.* v. *Comm. of Massachusetts,* 73 U.S. 632 (1867); *Educational Films Corp. of America* v. *Ward,* 282 U.S. 379 (1931); *Tradesmens Natl. Bank of Oklahoma City* v. *Oklahoma Tax Commission,* 309 U.S. 560 (1940); *Werner Machine Co.* v. *Director of Div. of Taxation,* 350 U.S. 492 (1956). The state taxation of corporate franchises may be levied upon a valuation or may be an excise tax and may be proportioned either to the value of the privileges granted or to the extent of their exercise or to the results of such exercise. *Reading R.Co.* v. *Pennsylvania,* 82 U.S. 284, 296 (1873). Thus, a franchise tax is a tax on the privilege of exercising a corporate franchise and may be computed on net corporate assets or net income. *Tradesmens Natl. Bank of Oklahoma City* v. *Oklahoma Tax Commission,* 309 U.S. at 564. In decisions of this Court the terms "franchise tax" and "excise tax" are used interchangeably. See, by way of illustration, *Tradesmens Natl. Bank of Oklahoma City* v. *Oklahoma Tax Commission, supra, Pacific Co.* v. *Johnson, supra, Educational*

Films Corp. of America v. *Ward, supra, Flint* v. *Stone Tracy Co., supra.*

Under the analysis in *Educational Films Corp. of America* v. *Ward,* 282 U.S. at 388, it is clear that T.C.A. § 67-751 is an excise tax and not a direct tax on income. The bank excise tax has "no application independent of the corporation's enjoyment of the privilege of exercising its franchise." If a bank, such as the Appellant, had not exercised the privilege of doing business in 1977, "it would not have been subject to any tax under this statute [for 1977], although it had received, during the preceding fiscal year, income which the statute makes the measure of the tax." 272 U.S. at 388.

The question of whether the Bank Tax affects the immunity of federal securities under the federal immunity doctrine is a question of whether the tax is a direct tax such as a property or income tax on federal bonds or the interest thereon, (*see, e.g., Educational Films Corp. of America* v. *Ward,* 282 U.S. at 389) or whether the "legal incidence" of the tax falls on the federal government. *United States* v. *County of Fresno,* 429 U.S. 699, 705 (1977). From the above discussion, it is clear that the excise tax on bank earnings is a franchise tax and not a direct tax on income. The incidence of this tax is upon the banks pursuant to T.C.A. § 67-760. The tax is clearly not imposed upon the United States or its instrumentalities.

The Tennessee Supreme Court correctly rejected the Appellant's contention that the Excise Tax on Bank Earnings levied by T.C.A. § 67-751 is a property tax. In *Woods Lumber Co.* v. *McFarland,* 209 Tenn. 667, 673, 355 S.W.2d 448 (1962) it was held that the state excise tax was "neither a property tax nor an income tax," but was a tax based upon the privilege of doing business in the corporate form in Tennessee. Since the bank excise tax is an extension of the state excise tax, it is likewise not a property tax.

In *Tennessee Trailways, Inc.* v. *Butler,* 213 Tenn. 136, 145, 373 S.W.2d 201 (1963), it was observed that:

> Ad valorem taxes are imposed directly upon property and the tax follows the property into any hands which it may pass. A privilege tax, however, is not directly related to any property, but imposed upon persons or business engaged in doing some specific act.

It cannot be said that the excise tax levied in T.C.A. § 67-751 is directly imposed on property. Rather, it is clear that the tax is imposed on banks for the exercise of the privilege of doing business.

It is true that the bank excise tax is in lieu of a tax on intangible personal property designated as "shares of banks and banking associations" and, thus, a substitute for the prior bank share tax (T.C.A. § 67-715, *et seq.*). However, the "in lieu of" provisions in T.C.A. § 67-751 do not determine the nature and operation of the excise tax. If the statute provided instead that a "property tax" was levied "in lieu of" an "excise tax", surely the Appellant would not concede that the nature and operation of the tax was an excise tax.

The "in lieu of" recitals were placed in T.C.A. § 67-751 to satisfy the constitutional requirements of Article 2, Section 28 of the Tennessee Constitution. The Tennessee Legislature enacted the Bank Tax in accordance with the grant of authority found in Article 2, Section 28 of the Tennessee Constitution which reads in part as follows:

> Banks, insurance companies, loan and investment companies, savings and loan associations, and all similar financial institutions, shall be assessed and taxed in such manner as the Legislature shall direct . . . provided further that teh taxes imposed on such financial institutions, and paid by them, shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock,

> policies of insurance, customer savings and checking accounts, certificates of deposit, and certificates of investment, by whatever name called, including other intangible corporate property of such financial institutions.

In compliance with this provision the excise tax contains in its last sentence the following provision:

> The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit, and certificates of investment, by whatever name called, including other intangible property of such bank or banking association provided that such bank or banking association shall nevertheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under Chapter 27 of Title 67 and all other taxes to which it is currently subject.

The "in lieu of" provision in the introduction to T.C.A. § 67-751 which states that the excise tax is in lieu of the intangible personal property tax on bank shares, is merely a recital to show that the repeal of the prior bank shares tax was constitutional and that the remaining share tax on the shares of loan companies, investment companies and cemetery companies (T.C.A. §§ 67-715 to 67-728) is in accordance with the rule that requires that property taxes shall be equal and uniform [*see Metropolitan Gov't.* v. *Hillsboro Land Co.*, 222 Tenn. 431, 436 S.W.2d 850 (1958)] and once enacted any partial repeals must comply with the Article 2, Section 28 constitutional mandate of equal and uniform taxation. *Briggs* v. *Beeler*, 180 Tenn. 198, 173 S.W.2d 144 (1943).

With respect to the alternate minimum tax levied by T.C.A. § 67-752, it is noted that this tax is not at issue in this case. The parties stipulated that no tax would be owing by the Appellant if the income in question was deducted from Appellant's gross income. (J.A. 39a-40a). This stipulation, in essence, states that

there is no minimum tax owing. (The minimum tax calculation for 1978 is found in the Record at p. 64, and shows a zero minimum tax). When the excise tax, T.C.A. § 67-751, was enacted, local governments were concerned that there would be a sudden reduction in revenue. The minimum tax which was tied to a tax base computed from sixty percent (60%) of book value as of December 31, 1976, provided the mechanism for phasing in the excise tax. It was anticipated that the banks' real and tangible personal property would grow in value and, ultimately exceed sixty percent (60%) of book value as of December 31, 1976, thereby eliminating the minimum tax base.

On the basis of the above analysis, the Appellees conclude that the Tennessee Excise Tax on Bank Earnings, T.C.A. § 67-751, is a franchise tax.

B. The Tennessee Bank Excise Tax is Nondiscriminatory.

1. Introduction

The Defendant submits that the Tennessee Supreme Court has correctly determined that the Tennessee bank tax does not discriminate against federal obligations. At the outset, it is helpful to note the boundaries of the states' taxing powers in regard to federal securities. The basic rule is that federal obligations or the income therefrom may not be subjected to a direct tax such as a property or income tax. This doctrine was first established in the case of *Weston* v. *City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829) which followed the doctrine of federal immunity announced in *McCullough* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819). Most of the cases which have invalidated state or local taxes because of their inclusion of Treasury obligations have turned on the nature of the tax involved. *See, e.g., Home Savings Bank* v. *City of Des Moines*, 205 U.S. 503 (1906) [a state bank shares tax held invalid because assessed to bank], *Weston* v. *City Council of Charleston, supra*, [a property tax on U.S. obligations], *People* v. *Weaver*, 100

U.S. 539 (1880), [a property tax on U.S. obligations], *Farmers & Mechanics Savings Bank* v. *Minnesota,* 232 U.S. 516, 521 (1914) [a direct property tax imposed upon federal obligations], *Society for Savings & City of Cleveland* v. *Bowers,* 349 U.S. 143 (1955) [a share tax imposed on bank held invalid], *New Jersey Realty Title Insurance Co.* v. *Div. of Tax Appeals,* 338 U.S. 665 (1950) [tax on capital stock of corporation held invalid].

Conversely, state taxes have been upheld even though federal obligations were included in the measure of those taxes because the taxes were not direct taxes on the obligations as was determined by the nature of said taxes. For over one hundred years it has been recognized that franchise taxes are a valid exercise of a state's taxing power even when federal obligations are included within the measure of such taxes. *See Werner Machine Co.* v. *Director of Div. of Taxation,* 350 U.S. 942 (1956), *Society for Savings* v. *Coite,* 73 U.S. 594 (1868), *Provident Institution for Savings* v. *Mass.,* 73 U.S. 611 (1868), *Hamilton Co.* v. *Massachusetts,* 73 U.S. 632 (1868). For approximately one hundred and twenty years it has been recognized that a tax on bank shares in the hands of the shareholders does not violate federal immunity even though the tax may be measured by corporate assets which includes federal obligations.[1] *See Van Allen* v. *Assessors,* 70 U.S. 575 (1866), *First National Bank* v. *Commonwealth,* 76 U.S. 353 (1870), *Cleveland Trust Co.* v. *Lander,* 184 U.S. 111 (1902), *Home Savings Bank* v. *Des Moines,* 205 U.S. 503 (1906), *Des Moines Natl. Bank* v. *Fairweather,* 262 U.S. 103 (1923), *Society for Savings* v. *Bowers,* 349 U.S. 143,

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[1] For a survey of the history of the decisions and congressional action relating to the taxation of national banks see an article by Simeon E. Leland entitled, *The History and Impact of Section 5219 on the Taxation of National Banks* printed in Appendix 6 (at pp. 145-354), U.S. Congress, Senate, Banking, Housing and Urbans Affairs Committee, *State & Local Taxation of Banks,* Report of Study under Public Law 91-156, prepared by Board of Governors Federal Reserve System, 92 Cong. 1st Sess., 1971, Committee Print.

(1955). In the area of estate and inheritance taxes it has been held that federal obligations may be included in the measure of such taxes without affecting the validity of those taxes. *Plummer* v. *Coler,* 178 U.S. 115 (1900). In each of these categories of taxes, this Court has found that the incidence of the tax is on a legitimate object within the boundaries of the state taxing power and not on the federal obligations and, therefore, does not constitute a direct tax on the federal obligations.

The Appellees submit that the examination of the validity of a state tax under the federal immunity decisions of this Court requires first, a determination as to the nature of the tax, and secondly, a determination of whether the tax discriminates against United States obligations. The Appellees submit that these criteria are distinct and should be differentiated in application. Thus, a direct tax against United States obligations is invalid because of its nature, however, an excise tax such as found in *Miller* v. *Milwaukee* 272 U.S. 713 (1927) is a valid tax by virtue of its nature but constitutionally defective because it discriminated against federal obligations. In some decisions a direct tax may also discriminate against the United States or its instrumentalities. *McCullough* v. *Maryland, supra.* But in most instances the merger of the issue of discrimination and the "direct burden test", as illustrated in *Schuylkill Trust Co.* v. *Pennsylvania,* 296 U.S. 113 (1935), obscures the nature of the unlawful discrimination prohibited by the federal immunity doctrine and, thus, prohibited by 31 U.S.C. § 742.

The Defendant contends that the true nature of unlawful discrimination is found in *Miller* v. *Milwaukee* which held that federal obligations are unlawfully discriminated against when they are singled out for special treatment by a tax which would have otherwise been valid. This case represents one end of the spectrum on this issue. At the other end would be a tax such as a franchise tax, which includes all income or property without any deduction or exemption. This tax would clearly be valid and

nondiscriminatory. *Werner Machine Co.* v. *Director of Div. of Taxation,* 350 U.S. 492 (1956). The Tennessee Bank Tax is somewhere between these two extremes. The question is where the line of validity is to be drawn. Cases other than *Miller* v. *Milwaukee* have not established a clear standard. In the cases which have found state taxes to be valid in their nature, this Court has in passing addressed the issue of discrimination, however, in those instances the opinions have merely recited without detailed analysis that it is clear that there is no discrimination. *See, e.g., Werner Machine Co.* v. *Director of Div. of Taxation.*

There appear to be three instances in which state taxes have been found to be invalid because they discriminated against federal obligations. *Miller* v. *Milwaukee,* 272 U.S. 713 (1927); *MacAllen Co.* v. *Massachusetts,* 279 U.S. 620 (1929), *reh. den.,* 330 U.S. 513, and *Schuylkill Trust Co.* v. *Commonwealth of Pennsylvania,* 296 U.S. 113 (1935). A review of these decisions indicates that *Miller* v. *Milwaukee* is the only viable precedent on this question.

2. Decisions Primarily Concerned With Discrimination Against Federal Obligations.

The Appellees submits that the rule of *Miller* v. *Milwaukee* is the only viable test of discrimination and that the decisions of *MacAllen Co.* v. *Massachusetts* and *Schuylkill Trust Co.* v. *Commonwealth of Pennsylvania,* which were derivations of *Miller,* have been effectively limited to their facts by subsequent decisions of this Court.

a) *The Miller* v. *Milwaukee Decision*

The nature of the discrimination in *Miller* v. *Milwaukee* was that United States obligations were singled out by a tax which would have been otherwise valid. This tax was imposed upon the dividends received from corporate income to the extent that the income of the corporation had not been previously taxed. Under the facts stipulated in that case, the portion of the

dividends in question came directly from income accuring from United States bonds issued by virtue of acts of Congress, passed April 24, 1917 and September 24, 1917. Justice Holmes delivered the opinion of the Court and at page 715 stated:

> If the avowed purpose and self-evidence operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly, indirectly achieving the same result, the statute must fail even if but for its purpose of special operation it would be perfectly good.

b) **The MacAllen Decision**

MacAllen Co. v. *Massachusetts,* 279 U.S. 620, (1929), *reh. den.,* 230 U.S. 513, applied the rule of *Miller* v. *Milwaukee* to find that an amendment to the Massachusetts excise tax rendered it invalid because the tax was aimed at the inclusion of United States securities which had been previously excluded. The Massachusetts tax was an excise tax levied on corporatons. This tax was amended in 1925 to provide the inclusion of federal bonds within the measure of the tax even though they had been previously excluded from the measure of said tax. A majority found that this amendment constituted an intentional discrimination on the part of Massachusetts which was forbidden by *Miller* v. *Milwaukee.*

The dissenting opinion written by Justice Stone and concurred in by Justices Holmes and Brandeis, took the position that the Massachusetts excise tax did not evidence the "sinister purpose" present in *Miller* v. *Milwaukee.* The dissent noted that the tax was designed to impose on corporations generally a tax similar to the excise on national banks measured by net income which was recommended by the Massachusetts legislative committee as a means of avoiding an existing discrimination between the taxation of state and national banks. The committee's recommendation was an effort to comply with the requirements of Revised Statutes § 5219, 12 U.S.C. § 548.

In subsequent decisions involving state excise taxes, the rule in *MacAllen Co.* v. *Massachusetts* was severely limited and ultimately repudiated. In *Educational Films Corp. of America* v. *Ward, supra,* decided in 1931, this Court was faced with a New York excise tax upon the privilege of exercising the corporate franchise which was measured by the corporation's entire net income which included interest on federal obligations. It was held that the New York tax was a valid nondiscriminatory tax upon corporate franchises notwithstanding the inclusion of exempt property or income in the measure of it. This Court observed that *MacAllen Co.* v. *Massachusetts, supra,* did not overrule *Flint* v. *Stone Tracy Co.* and similar decisions. *MacAllen Co.* v. *Massachusetts* was distinguished on the basis that it was brought within the rule of *Miller* v. *Milwaukee* because the exempted securities which had previously been excluded from the measure of the tax were included by an amendment specifically intended to reach the exempt income. 282 U.S. at 392.

In *Pacific Co.* v. *Johnson,* above, the *MacAllen* decision was analyzed at 285 U.S. 494 as follows:

> There the Commonwealth, which had long imposed a tax on corporate franchises measured by the taxable income of the corporation, amended its statutes, so as to add the income from tax exempt bonds of the federal government to the measure of the tax. It was held that this change of taxation policy, embodied in the statutes and adopted, as though it had been so declared in precise words, for the very purpose of subjecting these securities *pro tanto* to the burden of the tax was invalid. Thus, the legislative abandonment of the policy which had previously discriminated in favor of tax exempt securities was treated as a discrimination against them, and the tax, although in fact, nondiscriminatory, was condemned as analogous to the discriminatory tax held invalid in the *Miller* case.

This same analysis was also utilized in *Tradesmen's National Bank of Oklahoma City* v. *The Oklahoma Tax Commission*, 60 U.S. at 692, in a challenge to the Oklahoma excise tax on national banks on the basis that said tax included income from federal bonds. With respect to the Oklahoma tax and its relationship to the *MacAllen* case, the *Tradesmens'* decision at 309 U.S. 566 said:

> It cannot be said that the Oklahoma tax in question here was aimed at tax-exempt federal securities in the manner thus disclosed and condemned in the *MacAllen* case. The history of the Oklahoma legislation on this subject discloses only that it sought to change its policy pursuant to the express authorization conferred by R.S. § 5219. It has effected its purpose by including within the measure of its franchise tax on national banks the entire net income without respect to source and without discrimination against tax exempt federal securities. *See First National Bank* v. *Oklahoma Tax Commission*, 185 Okla. 98, 90 P.2d 438.
>
> We do now decide just what circumstances, *if any*, would bring a situation within the precise scope of the *MacAllen* case, *assuming that case has vitality*. (Emphasis added)

c. The Schuylkill Decision

The decision in *Schuylkill Trust Co.* v. *Commonwealth of Pennsylvania, supra,* also appears to be of limited precedential value. The tax challenged there was a share tax which required the payment of the tax first to be made by the corporation as an agent of the shareholders with a remedy against the shareholders for any monies paid. The tax was not laid upon the capital of the trust company. The tax allowed a deduction of assets invested in the shares of other corporations taxed by Pennsylvania on their capital or shares and also a deduction for assets invested in shares of other corporations relieved from tax

on their shares or capital by Pennsylvania. The purpose of the first deduction was to avoid double taxation; the purpose of the second deduction was to promote the policy of the Commonwealth to encourage certain types of business (manufacturing corporations, laundering corporations, and corporations for processing and curing meats).

As noted above, there are instances in which the question of whether the tax is a direct tax on federal obligations is merged with the question of whether there is discrimination. *Schuylkill Trust Co.* appears to be an example of such a merger of issues derived from *Missouri* v. *Gehner, infra.* At 296 U.S. 119-120, the following statement of the issue is found:

> If among those assets are found shares of stock of Pennsylvania corporations which, or whose shares, have been declared exempt by the state, this exemption is affected in the instant case by taking them wholly or partially out of the net assets which are the base for the tax. The appellant says this demonstrates that the tax is one on assets. If the appellant is right, the exaction operates as a discrimination against government securities and other assets exempt under federal law. *Missouri ex rel. Missouri Insur. Co.* v. *Gehner,* 281 U.S. 313, 74 L.Ed. 870, 50 S.Ct. 326. If the tax is one truly on the independent property evidenced by the ownership of a share of corporate stock, its collection does not discriminate against the United States securities.
>
> We think that the issue of discrimination is not to be resolved by choice between the two contentions as to the nature of the tax.

In spite of the disclaimer in the statement of the issue, it appears that the decision treats the share tax as if it is a direct tax on the federal securities. The analysis of this issue found a discrimination based on a conclusion that if the burden of the tax was not imposed on some securities which were exempt from the share tax, then it must fall on the remaining securities. Since

United States bonds would be included with the company's remaining assets, then it must be concluded that the tax is imposed on United States securities. Even though the share tax appears valid under the test applied in *Society of Savings* v. *Bowers, supra,* it was concluded that there was a direct burden on the United States securities and the opinion at 296 U.S. 120 said:

> ...it seems clear that to refuse to exempt United States securities from the measure of the tax is to lay a tax reckoned upon their value.

The analysis then proceeded to compare a hypothetical company which would own *only* stocks exempted and excluded from the measure of the share tax with a company which owned United States bonds which were included along with the company's other assets in the measure of the tax. The opinion said:

> It is impossible to avoid the conclusion that the law discriminates in favor of the former [company] and against the latter solely by reason of ownership of such federal securities.

Appellee submits that this type of comparison does not support the conclusion. The reason that the hypothetical company had no tax was because it owned stock which was already taxed or which was exempted. The latter company was not discriminated against "solely" because it owned federal securities. If the company had held no federal securities, its remaining assets would have been subject to the tax. And if the federal securities were replaced by assets of the same nature as its other assets, it would have had the same tax burden. This type of comparison does not establish discrimination and was rejected by the *Tradesmen's* decision at 309 U.S. 568 as follows:

> Discrimination is not shown merely because a few individual corporations, out of a class of several thousand which ordinarily bear the same or a heavier tax burden,

may sustain a lighter tax than that imposed on national banking associations.

Further, the Appellees contend that the "direct burden" test on which the *Schuylkill* analysis is based has subsequently been modified and replaced by the "legal incidence" test. In *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 159 (1937), this Court rejected the taxpayers' contention that the tax was an unconstitutional interference with the government of the United States because the tax increases the cost to the government of the service rendered by the taxpayer. In *Werner Machine Co.* v. *Director of Div. of Taxation,* 350 U.S. at 494, this principle was reiterated with respect to federal bonds:

> And since this is a tax on the corporate franchise, it is valid depsite the inclusion of federal bonds in the determination of net worth. This Court has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property.

Thus, the Appellees conclude that the "direct burden" test applied in *Schuylkill* is no longer applicable and the precedential value of *Schuylkill* is accordingly limited.

The Appellee further submits that *Schuylkill* has been limited to its facts because the authority relied upon for its premise of discrimination has been repudiated. The sole case cited for the discriminatory effect was *Missouri* v. *Gehner, supra.*

In *Missouri* v. *Gehner* the tax imposed was a property tax on the net worth of an insurance company. This tax was clearly a property tax, and the calculation of the tax excluded United States bonds from the taxable amount. The complaint of the taxpayer stemmed from the fact that in arriving at net worth subject to tax the liabilities associated with the United States bonds were also deducted from total liabilities. As a result, net

worth was effectively increased. The taxpayer claimed that the federal bonds should be deducted from the taxable property without a corresponding deduction of liabilities with respect to said bonds from total liabilities. The majority opinion at 281 U.S. 321-322 stated:

> But where, as in this case, the ownership of United States bonds is made the basis of denying the full exemption which is accorded to those who own no such bonds, this amounts to an infringement of the guaranteed freedom from taxation. It is clear that the value of appellant's government bonds is not disregarded in making up the estimate of taxable net values. That is in violation of the established rule. *National Life Ins. Co.* v. *United States, supra; Northwestern Ins. Co.* v. *Wisconsin,* 275 U.S. 136, 48 S.Ct. 55, 72 L.Ed. 202; *Miller* v. *Milwaukee,* 272 U.S. 713, 47 S.Ct. 280, 71 L.Ed. 487.

In *United States* v. *Atlas Life Insur. Co.,* 381 U.S. 233 (1965), this Court reviewed the decisions in *National Life Insur. Co.* v. *United States,* 277 U.S. 508 (1928) and *Missouri* v. *Gehner, supra.* At 381 U.S. 245 it was noted that the rule for which these cases are cited is that:

> A state may not subject one to a greater burden upon his taxable property merely because he owns tax-exempt government securities.

With respect to the application of this rule in *Gehner* (quoted above) to establish discrimination against United States bonds, this Court said:

> It is obvious that the tax in *Gehner* did not infringe this *rule.*

The *Gehner* analysis is applied in *Schuylkill.* Yet, as in *Gehner, Schuylkill* did not violate the *National Life* rule.

Assuming that the tax there was a valid share tax, which it appears to be, tax exempt securities could properly be included in the measure of the tax. The ownership of the securities deductible under the Pennsylvania share tax law did not increase the tax burden. It decreasd the tax. Also, the ownership of exempt securities did not increase the rate on the remaining taxable value.

The Appellee submits that the repudiation of the application of the *National Life* rule in *Gehner,* as noted in *United States* v. *Atlas Life Insur. Co.,* 381 U.S. at 244-247, likewise affects *Schuylkill.*

3. The Tennessee Bank Excise Tax Is Not Discriminatory Under The Standards Established By This Court.

The Defendant submits that the test for discrimination in the area of immunity of federal obligations is stated in *Miller* v. *Milwaukee, supra.* Under this test a statute would be found to be discriminatory if it purposefully singled out United States obligations and subjected them to special treatment. A corollary to the *Miller* rule is the rule in *National Life Insur. Co.* v. *United States, supra,* which states that a state may not subject one to a greater burden upon his taxable property *merely* because he owns tax exempt government securities. The Appellant suggests that there is another rule for determining discriminatory statutes found in *Werner Machine Co.* v. *Director of Taxation, supra.* This rule is paraphrased by the Appellant to state that a tax statute discriminates against obligations of the United States where it imposes a higher tax on taxpayers who hold federal obligations than on those who hold other assets. This rule is also a corollary to the rule in *Miller.* All of these rules come to the same conclusion, that is, federal obligations cannot be singled out and taxed at a higher rate than other taxable property or income nor can the mere ownership of federal obligations be the basis upon which to impose a higher

rate of tax upon the taxpayer's remaining taxable assets or income.[2]

The Appellees submit that the Tennessee Supreme Court correctly found that the Tennessee Excise Tax on Bank Earnings did not violate the *Miller* rule. The Appellees submit that the bank excise tax does not violate the *Miller* rule or any of its corollaries. It does not single out federal obligations or the interest therefrom or in any other way treat them as special or direct objects of taxation as occurred in *Miller* v. *Milwaukee, supra.* The rate of tax per taxable dollar of taxable income is not higher "solely" because a taxpayer owns federal bonds. All items of taxable income are taxed equally. The Appellant's statement that the tax varies with the amount of income from federal bonds is a tautology since the tax in question varies with the amount of taxable income produced. The Tennessee Excise Tax on Bank Earnings has not singled out federal obligations for special treatment but rather those obligations are included among all other items of taxable income in the measure of this tax.

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[2] *Phillips Chemical Co.* v. *Damas Independent School District,* 361 US 376, 380 (1960) and *Moses Lake Homes, Inc.* v. *Grant County,* 365 US 761 (1961) are examples of a higher rate of taxation being levied solely because the taxpayer leased federal property. In *Phillips Chemical,* this Court examined the question of whether such discrimination could be justified. 361 US at 382. The School District argued that the favorable treatment given state lessees was justified by the state's gain from rental revenue which offset the loss in taxes. This Court held that this rationale did not justify the discrimination against lessees of federal property. 361 US at 384.

Other taxpayers have advanced *Phillips Chemical* to support discrimination challenges, however, the courts have found that the classifications in question were justified and that the local tax burden was not shifted to the interests in federal property as it had been in *Phillips Chemical. International Paper Co.* v. *County of Siskiyou,* 515 F2d 285 (9th Cir. 1974). Similarly in *Chrysler Corp.* v. *Township of Sterling,* 410 F.2d 62 (6th Cir. 1969), the court found that the discriminatory provision was in accord with state and federal policy and that the discriminatory effect was minimal.

The Appellees submit that the rulings in *MacAllen* and *Schuylkill Trust* have been limited to their facts and the implications of those decisions have been repudiated. As noted above, the general rules stated in those cases may retain their validity but the application of those rules to the facts of those cases and the implications therefrom have not been applied in subsequent decisions of this Court. Accordingly, the Appellees submit that no further implications should be drawn from those decisions.

The test for discrimination against federal obligations is whether or not they are singled out and subjected to a higher tax than imposed upon other items of income. It is clear that the Tennessee Excise Tax on Bank Earnings does not single out federal obligations and impose a higher tax on those obligations and, thus, this tax satisfies the test in *Miller* and its corollaries. The net earnings defined under the Tennessee excise tax, T.C.A. § 67-2704, is based upon federal taxable income subject to certain deductions and additions. The trend has been for the states to use federal income as the tax base for their taxes both for the convenience of taxpayers and tax administrators.[3] Thus, the issue in this case comes down to the fact that the State of Tennessee by using federal taxable income to define net earnings includes income from federal obligations but excludes state bonds. The Appellees submit that this is a legitimate exercise of the State of Tennessee's power to structure its tax system to fit its fiscal needs. Further, the Appellees submit that the exemption of income from state bonds is not *per se* discrimination.

The Appellant's argument contains the hidden premise of the equivalence of Tennessee bonds with federal bonds. Generally, discrimination is the unequal treatment of equals. The Plaintiff's argument assumes that Tennessee bonds are equivalent to federal bonds, and since Tennessee bonds are not

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[3] 36 states use federal taxable income as their state tax base. *See* Table in [1982] State Tax Guide - All States (CCH) pp. 1042-1043.

included in the tax then there must be a discrimination against federal bonds. The Appellees submit that the hidden premise of equivalence is not a self-evident proposition and must be proved. The treatment of this type of question was addressed by Justice Cardozo in the dissent to *Schuylkill Trust Co. v. Commonwealth of Pennsylvania, supra.* Justice Cardozo, joined by Justices Brandeis and Stone, was unable to "discover any unlawful discrimination" against the federal obligations in the Pennsylvania share tax merely on the basis that that tax had provided for certain exemptions. 296 U.S. at 132. Justice Cardozo noted that the assets deducted under the Pennsylvania tax were not equivalent to United States obligations. He said at 296 U.S. 129 the following:

> The vast classes of securities — bonds and notes of every kind, as well as shares of stock in many and varied enterprises — are in the same position for the purpose of the tax in suit as government bonds and notes. The few investments that occupy a different position are not comparable in kind or in attractiveness to the obligations of the government and do not substantially compete with them. To hold that there was discrimination here in any forbidden sense is to hold that bonds and notes of the United States must be deducted from the value of the shares if there is a deduction of any form of investment, no matter how minute in amount or alien in quality.

Justice Cardozo characterized this notion of discrimination as follows, at 296 U.S. 129:

> This is to lose sight of the essence of discriminatory statutes and to stick in the bark of a hard and narrow verbalism.

In proposing a standard by which to determine the presence of discrimination, Justice Cardozo suggested the following test:

> The discrimination, as has been said, must be so marked as to justify the inference that it was unfriendly in design or at the very least it must favor forms of investment that are in substantial competition with government securities.
>
> 296 U.S. at 129-130

This test was predicated on the analogy found in the authorization for state taxation of national banks by Revised Statutes §5219, 12 U.S.C. § 548 and the cases applying that section. The standard for determining unlawful discrimination in the bank share cases was whether the acts in question were "unfriendly discrimination."

Justice Cardozo stated the policy which supported this test as applied in the bank share cases as follows:

> "In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect on the other. *Metcalf & Eddy* v. *Mitchell,* at p. 523. A sterile formalism would quickly lead to an impasse, the activities of the states checked because of an indirect effect upon the agencies of the federal government, and the federal activities checked for fear of a like effect upon the agencies of the state. One must view the subject in a large way if government is to go on at all."
>
> 296 U.S. at 127.

To illustrate the standard of unfriendly discrimination or its counterpart discrimination in favor of investments which are in substantial competition with government securities Justice Cardozo made reference to cases under the National Bank Tax statute, 12 U.S.C. § 548. Under that statute the taxation of national bank shares was limited by a standard of discrimination which stated that the taxes on the bank shares could not be at a greater rate than was assessed against other monied capital in the hands of individual citizens of such states coming into com-

petition with the business of national banks. This test is essentially the same standard as the higher tax test found in *Werner Machine Co.* v. *Director of Taxation, supra.*

To illustrate this test Justice Brandeis cited *Hepburn* v. *School Directors,* 90 U.S. 480 (1875) which involved a state exemption of mortgages, judgments, recognizances, and monies owing on articles of agreement for the sale of real estate. This Court said there was no hostile purpose in this exemption or unfriendly discrimination to the taxation of bank shares as follows:

> "It could not have been the intent of Congress to exempt bank shares from taxation because some monied capital was exempt."
>
> (quoted at 296 U.S. 130).

Justice Cardozo also cited *Adams* v. *Nashville,* 95 U.S. 19 (1877) which was a case where a municipal ordinance gave an exemption from taxation to municipal bonds. This Court there stated as follows:

> "The plain intention of that statute [Rev. Stat. § 5219] was to protect the corporations [national banks] formed under its authority from unfriendly discrimination by the states in the exercise of their taxing power. *Id.* at p.22. Still, it was not intended to cut off the power to exempt particular kinds of property if the Legislature chose to do so."
>
> (quoted at 296 U.S. 130.)

Justice Cardozo also cited *Mercantile National Bank* v. *New York,* 121 U.S. 138 which was a case in which an exemption had been given to bonds of municipal corporations and also to deposits in savings banks. The taxpayer raised the protest of discrimination. After citing *Hepburn* v. *School Districts,* and *Adams* v. *Nashville,* the Court said:

> "The only limitation on deliberate reflection, we now think is necessary to add, is that these exemptions should be founded upon just reason, and not operate as an unfriendly discrimination against investments in national banks."
>
> (quoted 296 U.S. 131.).

The Appellees submit that the test for discrimination proposed by Justice Cardozo is a logical extension of the *Miller* rule and is in accord with the general notion that discrimination is the unequal treatment of equals. The Appellant's argument assumes that Tennessee and federal bonds are equivalents. The Appellees, however, submit that Tennessee bond issues are not in substantal competition with federal bonds. In addition, the Appellant has the affirmative burden of proof on this issue and has offered no proof to support this premise in its argument. *New York ex rel Amoskeag Sav. Bank* v. *Purdy*, 231 U.S. 373, 375 (1913), *Tradesmens National Bank* v. *Oklahoma Tax Commission*, 309 U.S. at 567.

The Appellees deny that it would be possible to establish that Tennessee bonds are in substantial competition with federal bonds. The Appellant suggests that since the amount of the bank excise tax would be lowered if investments were made in Tennessee obligations as opposed to federal obligations, the practical effect of this tax is to discourage a bank from investing in federal obligations and thus impairing the marketability of federal obligations. The Appellees would deny that this is the case.

A comparison of federal obligations with state obligations reveals that federal bonds are more widely held and are considered to be the most secure investment one can make. One of the purposes of enacting an exemption for state and local obligations from federal income tax is to encourage the needed investment in state and local government obligations. The market for tax exempt state and local bonds is considerably

smaller than the market for federal obligations. This is illustrated in the following comment by Roland Robinson as a part of his discussion of the tax exemption benefit:[4]

> State governments and governmental units at lower levels have unquestionably benefited in some measure from the privilege of selling securities that offer the investor exemption from federal income taxes. But this advantage has also had a clear counterpart: the market for state and local obligations has had to be found among investors exposed to income taxation. Investors who are tax exempt *per se* — pension funds, most savings and loan associations, and mutual savings banks, and non-profit foundations, for example — are not interested in such a market. Those who have limited tax liabilities — life insurance companies and lower income individuals, for example — have only a mild interest in this market. If, as some feel, the future direction of institutional investment is toward those institutions with limited tax liabilities or none at all, this forecasts a further discounting of the value of the privilege of borrowing on a tax-exempt basis.
>
> Furthermore, state and local government securities are not the first preference of any important group of investors. Commercial banks prefer loans. Individuals, and fire and casualty companies, mutual savings banks, and life insurance companies all prefer mortgages. State and local government obligations are the second choice of many investors and the first choice of very few.

The Appellees submit that the most significant factor in an investor's decision to purchase state and local obligations is the exemption from federal income tax. In a study by the Treasury

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[4] Roland I. Robinson, *Postwar Market for State & Local Securities*, at 99-100 (1960).

Department submitted to the Joint Economic Committee report on *State and Local Public Facility Needs and Financing,* prepared for the Subcommittee on Economic Progress of the Joint Economic Committee, Congress of the United States (U.S. Govt. Printing Office, Washington, D.C., December 1966, Vol. 2 at p. 332) it is noted that individuals subject to federal income tax in the higher income tax brackets are the largest purchasers of tax exempt state and local bonds. The Treasury study also described the impact of the tax exemption feature of state and local bonds on the investor's decision.(*See State and Public Facility Financing,* Vol. 2 at p.327) as follows:

> The relative return on investment at the margin on a taxable security yielding five percent (5%) or a tax exempt security of comparable quality yielding thirty percent (30%) of this, five percent (5%) or 1.5% would be a matter of indifference to an investor with a marginal tax rate of seventy percent (70%). Both offer the same after-tax marginal return. However, an investor whose marginal tax rate was fifty (50%) percent would find that unless the return on the tax-exempt security reaches at least fifty percent (50%) of the yield on a comparable taxable security, the after-tax yield on the taxable security will be better than the tax-exempt security. For an investor taxable at twenty percent (20%) the break-even yield on tax exempts would be eighty percent (80%) of the yield on taxable securities. The term "investors" in these comments covers both individual and institutional investors.

If this same analysis is applied with respect to the impact of the Tennessee Excise Tax on Bank Earnings the break-even yield on tax exempt investments would be ninety seven percent (97%) of the yield on taxable securities since the taxpayer is taxed on its net income at the rate of three percent (3%). As Justice Brandeis noted in *National Life Insur. Co.* v. *United States,* 277 U.S. at 528, the tax exempt feature of state and local bonds is always reflected in the price of those bonds. Consequently,

those bonds have lower rates than taxable bonds. Since the rates on state and local issues are in most instances less than the rates on federal bonds, it seems clear that the Tennessee Excise Tax on Bank Earnings would not have a significant impact upon an investor's decision to buy tax exempt bonds.[5]

In the *State and Local Public Facility Financing* study (Vol. 2 at p.19) the investment characteristics of banks were described as follows:

> Commercial banks must necessarily consider their liquidity requirements, the demand for loans from business and consumer borrowers and their legal needs to hold Government securities as collateral for government accounts. Funds that remain after these needs have been accommodated are then invested in "bonds" with municipal

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[5] If the Appellant's situation is taken as an example of whether an investor would make the decision to buy Tennessee bonds instead of securities taxable under T.C.A. § 67-751, it is found that the savings in Tennessee bank taxes are minute in comparison with the loss in income incident to such an investment decision. The Appellant's tax returns show that for 1976 Appellant had earnings from Tennessee securities in the amount of $348,348 on an investment of between $11 and $16.5 million in obligations of the State of Tennessee and its political subdivisions. In comparison the Appellant had an investment in federal securities in the amount of approximately $39 to $47.5 million and had earnings therefrom of $3,176,116. If the Appellant had invested in Tennessee obgliations instead of federal obligations the Appellant would have had a yield from an investment of an average of $43 million in state bonds (with a rate of return of $348,348 on an investment of $13 million) of approximately $1.2 million. The Appellant's average rate of profit in 1976 from gross earnings of $13,728,460 with net earnings of $1,389,522 is approximately ten percent (10%). If it is assumed that the average net earnings from the federal securities is at the rate of ten percent (10%), the net income on those securities would be $317,611. Thus, the total tax savings at the rate of three percent (3%) under the Tennessee bank excise tax would be $9,513.48. This tax savings is insignificant in comparison with a reduction in gross income on the order of $2 million.

security investments depending upon a comparison of the tax statutes that exempt yields with the bank's particular tax situation (income subject to tax).

Thus, it is seen that banks generally make investments in tax exempt bonds only after their preferred investments have been made. In the case of banks federal securities are preferred over tax exempts because federal securities qualify as collateral which is required for depositories of federal monies. 31 CFR §202.6(b).

By this brief analysis the Appellees would submit that the obligations of the State of Tennessee and its political subdivisions are not in substantial competition with federal obligations. Without proof of this equivalence of federal and state obligations the Appellant's argument of discrimination falls. The burden is on the Appellant to establish such discrimination if it exists. Since the record is silent on this point, the Appellees further submit that the Appellant's challenge should be rejected.

Thus, the Appellees conclude that the Tennessee Excise Tax on Bank Earnings does not violate the rule in *Miller* nor does it violate the test of substantial competition as discussed by Justice Cardozo in *Schuylkill Trust.*

4. T.C.A. § 67-751 Is A Legitimate Exercise Of The State's Taxing Power And Is In Accord With Congressional Intent And Policy.

The enactment of T.C.A. § 67-751 is a legitimate exercise of the State's taxing powers dealing with its domestic concerns and is not an infringement upon the perogatives of the National Government. The nature of the States' taxing powers was stated in *Allied Stores of Ohio* v. *Bowers,* 538 U.S. 522, 526 as follows:

> The States have a very wide discretion in the laying of their taxes. When dealing with their proper domestic concerns, and not trenching upon the perogatives of the National Government or violating the guaranties of the Federal Constitution, the States have the attribute of sovereign powers in devising their fiscal systems to insure revenue and foster their local interests.

Also see Phillips Chemical Co. v. *Dumas Independent School District,* 361 U.S. 376, 385 (1960). The enactment of the exemptions to encourage investments in particular enterprises is a legitimate exercise of the state taxing powers. *Allied Stores of Ohio* v. *Bowers, supra.*

The Appellees submit that the exemption of Tennessee bonds is an internal affair, by which the Tennessee Legislature subsidizes state agencies and its political subdivisions. It would be a useless exercise and impractical for the state to tax its own bonds and then in return redistribute the proceeds collected on those bonds to subsidize its agencies and political subdivisions.

Decisions involving the federal immunity doctrine have emphasized the importance of balancing the fiscal needs of state and local governments with the operations of the federal government so as to not unduly limit the respective taxing powers under our dual system of government. *James* v. *Dravo Contracting Co.,* 302 U.S. at 149. The need to balance the operations of state and federal government were observed in *Educational Films Corp.* v. *Ward* at 282 U.S. 391-392:

> This court, in drawing the line which defines the limits of the powers and immunities of state and national governments is not intent upon any mechanical application of the rule that government instrumentalities are immune from taxation, regardless of the consequences to the operations of government. The necessity of marking those boundaries grows out of our constitutional system, under which both

> ederal and state governments exercise the authority over one people within the territorial limits of the same state. The purpose is the preservation to each government, within its own sphere, of the freedom to carry on those affairs committed to it by the Constitution, without undue interference by the other. (citations omitted)

This Court has recognized that Congress is the proper agency to draw the line with respect to intergovernmental taxation and has further recognized that Congress takes careful steps to allow for the proper adjustment of intergovernmental tax burdens. In *Kern Limerick, Inc.* v. *Scurlock,* 347 U.S. 110, 116 (1954), this Court stated as follows:

> We are mindful, too, of the careful attention Congress has given in recent years to a proper adjustment of tax liabilities between the federal and the state sovereignties.

This Court also has recognized that Congress is the proper agency to make the difficult policy decisions necessarily involved in determining whether and to what extent private parties who do business with the government should be given immunity from state taxes. *City of Detroit* v. *Murray Corp.,* 355 U.S. 489, 495 (1958). *See also United States* v. *City of Detroit,* 355 U.S. 466, 474 (1958).

The Appellees submit that in the area of taxation of banks and federal obligations the Congress has manifested its intent and policy in 12 U.S.C. § 548 and 31 U.S.C. § 742. The amendment to 12 U.S.C. §548 by Public Law 91-156, 83 Stat. 434 was made to provide every state government "the greatest possible degree of autonomy with regard to the formulation of its tax structure." See S. Rep. No. 91-530, 91st Cong., 1st Sess., reprinted [1969] U.S. Code Cong. & Admin. News, 1594, 1595.

This amendment to the provisions for state taxation of national banks, Public Law 91-156, was conditioned upon a study to be made by the Board of Governors of the Federal Reserve System

to determine the probable impact on the banking systems and other economic effects of the changes in existing law to be made by Section 2 of the Act governing income taxes, intangible property taxes, so-called doing business taxes, and any other taxes which were or might be imposed upon banks. Public Law 91-156, Section 4(a).

In the report by the Board of Governors of the Federal Reserve System on *State and Local Taxation of Banks* (made pursuant to Public Law 91-156, Part II, pp. 66-67), the following observation was made with respect to the taxation of interest on federal obligations:

> Interest on federal securities is exempt from a direct tax on net income but may be included in the measure of an excise or franchise tax *according to or measured by* net income. This distinction was established for corporation taxation generally in Supreme Court decisions over an extended period, and for national banks specifically by the 1926 amendment of Section 5219. Under present law, the provisions in Section 5219 will lapse at the end of 1971. However the federal public debt statute has specified since 1959 that exemption of Federal Government obligations — [extends to every form of taxation except nondiscriminatory franchise taxes imposed on corporations].

In Part III of the Study on *State & Local Taxation of Banks* in the Federal Reserve Study at pp. 336-338 (Appendix pg. A-11-A-13) a chart is provided showing the treatment by the various states of interest received on government obligations as an element in state and local excise or income taxes.[6] The Appellees

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[6] This chart shows that Seven (7) States included federal obligations but excluded state and local obligations of the taxing state. Twenty-two (22) States included the state and local obligations of the taxing state and federal obligations. Six (6) States excluded the state and local obligations of the taxing state and federal obligations. Thirty-One (31) States included the state and local obligations of other States [See *Bonaparte* v. *Appeal Tax Court,* 104 U.S. 592 (1882)].

submit that Congress is aware of the manner in which states have structured their tax systems. Congress has recognized their needs and has declined to make any compensating adjustments to restrict the taxation of income from federal obligations by means of nondiscriminatory franchise taxes.

The Appellees conclude that the Tennessee Excise Tax on Bank Earnings is in accord with congressional intent and policy with respect to state taxation of income from federal obligations.

On the basis of the above analysis, the Appellees conclude that the Tennessee bank excise tax is nondiscriminatory.

II. The Interest From Farm Credit Securities Are Properly Included In The Tennessee Excise Tax On Bank Earnings

It is well settled that a state can impose a nondiscriminatory franchise tax on corporations, even though the tax is measured by net income including income from tax exempt securities. *Werner Machine Co., Inc.* v. *Director of Div. of Taxation, supra; Tradesmens National Bank* v. *Oklahoma Tax Comm., supra.; Pacific Co.* v. *Johnson, supra.; Educational Films Corp.* v. *Ward, supra.*

In *Tradesmens National Bank* v. *Oklahoma Tax Comm., supra.*, this Court gave identical treatment to United States Treasury issues and to bonds of the Federal Farm Loan Act, Joint Stock Land Bank bonds, Home Owners' Loan Corporation bonds, and Federal Land Banks bonds (309 U.S. at 562 n. 2) and, thus, found that the inclusion of Farm Credit securities in a nondiscriminatory franchise tax was proper and not in violation of the exemption provisions for such securities.

In *Inglehart* v. *Commissioner of Internal Revenue,* 77 F.2d 704 (5th Cir. 1935), it was held that the federal estate tax is an excise tax and, accordingly, the provision exempting from taxation Federal Farm Loan Bonds and the income therefrom (12

U.S.C. § 931) was not violated by including those bonds in the measure of the estate tax. The Appellees note that the statutes relied upon by the Appellant for the exemptions of the various Farm Credit issues (12 U.S.C. §§ 2055, 2079, and 2132) replaced the previous exemption provisions (Federal Land Bank, 12 U.S.C. § 931, Federal Intermediate Credit Bank, 12 U.S.C. § 1111; Banks for Cooperatives, 12 U.S.C. § 1138c) relied upon in the *Inglehart* decision. The Farm Credit Act of 1971 (Public Law 92-181) replaced the original exemption provisions with essentially the same language.

Accordingly, the Appellees submit that under the preceding analysis, Farm Credit securities are properly included within the Excise Tax on Bank Earnings, T.C.A. § 67-751.

CONCLUSION

For all of the foregoing reasons, the judgment of the Tennessee Supreme Court should be affirmed. If however, this Court is compelled to find the Tennessee Excise Tax on Bank Earnings unconstitutional, the Appellees request that this case be remanded for the consideration of the alternative positions taken by the Appellees below.

Respectfully submitted,

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BANK TAX

67-751. Excise tax on bank earnings — Rate. — There is hereby created a subclassification of intangible personal property which shall be designated as the "shares of banks and banking associations." All property in this subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject. [Acts 1977, ch. 140, § 1.]

67-752. Minimum tax. — In non event shall the tax imposed under § 67-751 upon any bank be less an ad valorem tax calculated on the basis of sixty percent (60%) of the book value of the bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value

of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits.

In determining the value to be assessed, the following shall be deducted from the sixty percent (60%) book value:

(1) The appraised value of all real property and tangible personal property otherwise owned and assessed to companies subject to this tax; and

(2) The appraised value of all real property in Tennessee occupied by companies subject to this tax and used for the purpose of conducting their business under a lease which provides that all ad valorem taxes on such property shall be paid by such companies and said lease has been registered in the county where such property is located.

The remaining value shall be assessed at forty percent (40%) and the resulting assessment shall be the amount to which the appropriate city and county tax rates shall be applied to determine the tax due and payable to the respective taxing jurisdictions. [Acts 1977, ch. 140, § 1.]

67-753. New banks. — The tax of any bank which has been in business less than five (5) years shall be reduced proportionately at the rate of one fifth (1/5) for each year less than five (5) it has been in business. [Acts 1977, ch. 140, § 1.]

67-754. Allocation of tax. — Unless the tax imposed herein shall be calculated under § 67-752, the total tax shall be allocated between the county and municipality where the principal office of the bank is located in the same proportion as the property tax rate of each taxing jurisdiction for the immediately preceding year shall bear to the sum of said property tax rates of both taxing jurisdictions; except that in those counties having populations of not less than 125,000 nor more than 140,000 according to the U.S. census population of 1970 or any subsequent federal census of population allocation shall further be determined in the following manner:

In those circumstances where a bank has branches or offices in municipalities other than the municipality where its principal office is maintained, but within the same county as its principal office, the total taxes due under §§ 67-751 — 67-753 shall be allocated between such county and such municipalities where its principal office and branches are located as follows:

(1) The percentage produced by the ratio of the deposits of each branch or office to the total deposits of the bank shall be determined as of January 1 of each year;

(2) The percentage so determined shall then be applied to the total tax calculated to be due under § 67-751 to determine the portion of the total taxes attributable to each branch or office;

(3) The branches or offices, including the principal office, shall then be grouped each to a common location so as to determine the aggregate taxes of all branches or offices located in each individual municipality within such county, and the total taxes allowable to each such common location shall then be divided between the county and each municipality in which such branches or offices are maintained in the same proportion as the property tax rate of each for the immediately preceding year shall bear to the total of the said property tax rates; or

(4) The percentage of the deposits of each branch or office as determined under subdivision (1) above shall be applied to total assessment resulting from calculations under § 67-752 to determine the portion of the total assessment attributable to each branch or office; and

(5) The branches or offices, including the principal office, shall then be grouped each to a common location so as to determine the aggregate portion of the assessment of all branches or offices located in each individual municipality within such county to which the appropriate

county and municipal tax rates applicable in each such municipality shall be applied to determine the tax due and payable to the respective taxing jurisdictions. [Acts 1977, ch. 140, § 1; 1979, ch. 255, § 1.]

67-755. Banks having branches in two or more counties. — In circumstances where a bank has branches or offices in a county or counties other than the county where its principal office is maintained, the total taxes due under §§ 67-751 — 67-763 shall be allocated between such counties and municipalities where its principal office and branches or offices are located as follows:

(1) The percentage produced by the ratio of each branch's or office's deposits to the total deposits of the bank shall be determined as of January 1 of each year and the percentage so determined shall then be applied to the total tax due to determine the portion of the total taxes attributable to each bank or office;

(2) The branches or offices shall then be grouped each to a common location so as to determine the aggregate taxes of all branches or offices located in each individual county and municipality; and

(3) The percentage of the total taxes allowable to each county and municipality shall then be divided between the county and municipality in which the branch or office is maintained in the same proportion as the property taxes of each for the immediately preceding year shall bear to the total of the said property tax rates of each. [Acts 1977, ch. 140, § 1.]

67-756. Administration of tax. — The administration of the tax imposed by §§ 67-751 — 67-763 shall be the duty of the division of property assessments of the state of Tennessee. The division shall have authority and power to prescribe forms upon which all banks shall make reports of such facts and information as will enable the division to ascertain the correctness of the

taxes to be paid. By July 1, or as soon thereafter as possible, the division of property assessments shall furnish to each bank a form, approved by the state board of equalization, to report its net earnings to said division on or before September 1 of each year.

After making the allocation required in § 67-754 on or before November 1 of each year, the division of property assessments shall certify to the chief executive officer, county trustee, municipal treasurer, or other official responsible for collecting the taxes due under §§ 67-751 — 67-763 the amount of taxes due from each bank subject to §§ 67-751 — 67-763.

In the event that any bank subject to the provisions of this act fails, refuses, or neglects to complete and file such form with the division of property assessements as above provided, the division of property assessments shall make a forced assessment of the amount of tax due from such bank on the basis of the best information available and shall give certification of same to the proper county and municipal officials with a copy to the chief official of said bank. Said notification shall be sent by United States mail, addressed to the last known address of the taxpayer and shall be effective when mailed.

In the event the division of property assessments shall fail to complete any assessment or notify any taxpayer by the dates provided herin, such failure shall not affect, in any way, the validity of such assessment; provided that an aggrieved taxpayer shall have the right to appeal to the state board of equalization at its next regular session. [Acts 1977, ch. 140, § 1; 1979 ch. 158, § 1.]

56-757. Division of property assessments' powers in obtaining evidence. — The division of property assessments shall have full power to summon witnesses, to inspect or require the production of books and papers, and to obtain and consider any evidence other than the reports submitted by such company, which it may deem proper or necessary. [Acts 1977, ch. 140, §1.]

67-758. Commissioner to certify net earnings — On or before August 1 of each year the commissioner of revenue shall certify to the director of the division of property assessments the net earnings for each bank doing business in the sate as determined pursuant to chapter 27 of title 67.

In the event that the net earnings of any bank subject to §§ 67-751 — 67-763 shall be finally redetermined for any period in accordance with chapter 27 of title 67, it shall be the duty of the commissioner of the department of revenue to certify the correct net earnings to the division of property assessments within thirty (30) calendar days after such final redetermination; the division of property assessments shall then have the duty to reassess the amount of tax owed for said period in accordance with the provisions and formulas set forth in §§ 67-751 — 67-763 and to certify to the county trustee, municipal treasurer, or other official responsible for collecting the tax the amount of any incrase in the tax due or the amount of any refund. [Acts 1977, ch. 140, § 1.]

67-759. Collection — It shall be the duty of the county trustee, municipal treasurer or other official responsible for collecting the ad valorem taxes to collect the amount of tax imposed by §§ 67-751 — 67-763. Such collection shall be in accordance with §§ 67-1101 — 67-1122 and any other sections of this Code or any applicable municipal charter relating to the collection and payment of ad valorem county or municipal taxes. [Acts 1977, ch. 140, § 1.]

67-760. Payment of tax. — For the purpose of collecting such taxes, and in addition to any other laws of this state relative to the imposition and collection of taxes, it shall be the duty of each bank to pay the taxes due under §§67-751 — 67-763, a prior lien being declared on all corporate property of such bank as of the first day of January of each year. [Acts 1977, ch. 140, § 1.]

67-761. Attachment of corporate property. — If the taxes shall not be paid by any bank subject to §§ 67-751 — 67-763, then the state, county or municipality may, after such tax may have become delinquent, proceed to collect the same by attachment on its corporate property in any court of competent jurisdiction, through counsel to be employed for that purpose. [Acts 1977, ch. 140, § 1.]

67-762. Administrative review. — Any bank which is aggrieved by any determination of the division of property assessments shall have the right to make a complaint or an appeal directly to the state board of equalization. All complaints and appeals shall be filed with the executive secretary of said board on or before August 1 of the year in which the appeal is prosecuted, unless such appeal results from an action the division of property assessments subsequent to July 1 next preceding. In such circumstances any complaints and appeals shall be filed with the executive secretary of said board within thirty (30) days following receipt of notification of such action by the division of property assessments. [Acts 1977, ch. 140, § 1.]

67-763. Rules and regulations. — The state board of equalization through the division of property assessments shall be charged with the implementation of §§ 67-751 — 67-762 and shall promote all necessary rules, regulations, instructions and procedures for its implementation. [Acts 1977, ch. 140, § 1.]

67-2704. "Net earnings" defined. — (a) The term "net earnings" is defined, at the option of the taxpayer, as:

(1) Federal taxable income before the operating loss deduction and special deductions provided for in §§ 241 — 247 and 249 — 250 of the Internal Revenue Code [24 U.S.C. §§ 241—247, 249, 250] prior to its amendment by the Economic Recovery Tax Act of 1981, Public Law No. 97-34, §§ 201 — 209; or

(2) Federal taxable income before the operating loss deduction and special deductions provided for in §§ 241 — 247 and 249 — 250 of the Internal Revenue Code [24 U.S.C. §§ 241—247, 249, 250] after its amendment by the Economic Recovery Tax Act of 1981, Public Law No. 97-34, §§ 201—209, plus one-tenth (1/10) of all depreciation used in computing federal taxable income.

(b) The term net earnings as defined in subsection (a) shall be subject to the following adjustments:

(1) There shall be added to the federal taxable income:

(A) Excise tax imposed by this state to the extent deducted in determining federal taxable income.

(B) Interest income earned on bonds and other obligations of other states or their political subdivisions less allowable amortization.

(C) Any deduction made pursuant to §§ 611-617 of the Inernal Revenue Code to the extent the deduction when added with similar deductions in prior years exceeds the cost of the property.

(D) Gains not recognized pursuant to § 337 of the Internal Revenue Code.

(E) The charitable contributions deduction claimed under § 170 of the Internal Revenue Code.

(F) Any capital loss carrybacks or carryovers deducted pursuant to § 1212(a) of the Internal Revenue Code.

(G) Anv expense or depreciation permitted as a deduction in computing federal taxable income solely as a result of lease characterizations permitted under Section 168 of the Economic Recovery Tax Act of 1981 which would not have been permitted in the absence of such act; it being the legislative intent that excise tax revenue not be reduced due

to lease characterizations made for the purpose of transferring investment tax credits and depreciation allowances from one business entity to another.

(2) There shall be subtracted from the federal taxable income:

(A) Dividends earned by a parent corporation from a subsidiary corporation where such parent owns eighty percent (80%) or more of the stock of the subsidiary.

(B) Any amount included in federal taxable income but not taxable under the law of this state.

(C) Any net operating loss incurred, which is defined as the excess of allowable deductions over total income allocable to this state for the year of the loss, and which may be carried over and allowed in succeeding tax years until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than three(3) years after the taxable year in which the net operating loss occurs.

(D) A portion of the gain or loss of the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis.

(E) Actual charitable contributions made by the corporation during the fiscal year.

(F) Losses not deducted pursuant to § 337 of the Internal Revenue Code.

(G) Any capital losses incurred during the fiscal year and not deductible under § 1211 (a) of the Internal Revenue Code.

(H) Any expense, other than income taxes, not deducted in determining federal taxable income for which a credit against the federal income tax is allowable. This subdivision shall apply to taxable periods ending on and after December 31, 1977.

(I) Any amount included in federal taxable income solely as a result of lease characterizations permitted under Section 168 of the Economic Recovery Tax Act of 1981 which would not have been permitted in the absence of such act.

(J) Any amount of depreciation or other expense which the taxpayer could have deducted in computing federal taxable income has it not made the election to enter into a lease transaction permitted under Sction 168 of the Economic Recovery Tax Act of 1981 which would not have been permitted in the absence of such act. [Acts 1976 (Adj. S.), ch. 537, § 29; 1978 (Adj. S.), ch. 841, §§ 1, 2; Acts 1982 (Adj. S.), ch. 886, §§ 1, 2; 1982 (Adj.S.), ch. 952, § 1.]

TABLE 20A.—TREATMENT OF INTEREST RECEIVED ON GOVERNMENTAL OBLIGATIONS AS AN ELEMENT IN STATE AND LOCAL TAXES MEASURED BY NET OR GROSS INCOME OF COMMERCIAL BANKS, JAN. 1, 1971

[CB—Commercial banks, State and national banks, OF—Other financial institutions, G—Corporations, generally, NB—National banks, SB—State banks]

State	State and local obligations of the taxing State	State and local obligations of other States	U.S. Government obligations	Differences from treatment of similar receipts of corporations	Reference to State revenue laws
(1)	(2)	(3)	(4)	(5)	(6)
Alabama	Included (CB, OF)	Included (CB, OF)	Included (CB, OF)	Interest from Alabama State and local obligations and U.S. Government obligations is exempt from taxation under the corporate tax law.	Sec. 425(b), title 51, Code.
Alaska[1]	do	do	do	Under the corporate tax law, interest from all 3 categories is exempt.	Sec. 43.70.030.
Arizona	Excluded (G)	Excluded (G)	Excluded (G)	None	Sec. 43-112.
Arkansas	Excluded (NB, OF, G)	Included (NB, OF, G)	Excluded (NB, OF, G)	do	Sec. 84-2008.
California	Included (G)	Included (G)	Included (G)	do	Sec. 24271.
Colorado	Excluded (G)[2]	do	Excluded (G)	do	Sec. 138-1-10.
Connecticut	Included (G)	do	Included (G)	do	Sec. 12-217.
Delaware	Excluded (SB, OF, G)	Included (SB, OF, G)	Excluded (SB, OF, G)	do	Sec. 1903, title 30.
District of Columbia	Included (CB, OF)	Included (CB, OF)	Included (CB, OF)	Cols. 2, 3, 4, are excluded from the corporate income tax.	Secs. 47-1701, 47-1703.
Florida	No income tax				
Georgia	Banks pay no income tax in Georgia.				
Hawaii	Included (CB, OF)	Included (CB, OF)	Included (CB, OF)	Corporations do not have to pay tax on the interest on U.S. Government and State and local obligations.	Sec. 241-4.
Idaho	Included (G)[3]	Included (G)	Included G)	None	Sec. 63-3022.
Illinois	Included (G, SB)	Included (G, SB)	Included (G, SB)	do	
Iowa	Excluded (CB, OF)	Included (CB, OF)	Included (CB, OF)	Corporations must include interest from Iowa State and local obligations and may exclude interest from Federal obligations.	Sec. 422.73.
Kansas	Included (CB, OF)[4]	Included (CB, OF)	do	Interest from Federal obligations is excluded from corporate tax.	Sec. 79-1109, 79-32, 117.
Kentucky	Banks are not taxed on their income in Kentucky.				
Louisiana	There is no tax on the net income of banks.				
Maine[5]	(a) Excluded (SB,G)	Excluded (SB,G)	Excluded (SB,G)	None	Sec. 5102
	(b) Excluded (SB,OF)	Excluded (SB,OF)	Included (SB,OF)	Interest from Federal obligations is excluded.	Sec. 206.34.
Maryland	Included (CB,OF)	Included (CB,OF)	Included (CB,OF)	Corporate taxable income does not include interest from Federal obligations.	Sec. 128A.

Massachusetts	Included (CB)	Included (CB,G)	Included (CB,G)	Some corporations do not pay tax on interest from Massachusetts State and local obligations.	
Michigan	Excluded (CB,OF)	Included (CB,OF)	Included (CB,OF)	Interest from Federal obligations is excluded from corporate tax.	Sec. 206.34.
Minnesota	Included (CB)	Included (CB)	Included (CB)	None	Sec. 290.08.
Mississippi	Banks are exempt from the Mississippi income tax.				
Missouri [8]	(a) Included (CB)	Included (CB)	Included (CB)	Interest from Missouri State and local obligations and U.S. obligations is exempt from taxation under corporate law.	Sec. 148.040.
	(b) Excluded (SB, G)	Included (SB, G)	Excluded (SB, G)	None	Sec. 143.040.
Montana	Banks are exempt from the income tax.				
Nebraska	Excluded (OF, CB)	Excluded (OF, CB)	Included (OF, CB)	None	Sec. 77-2716.
Nevada	There are no income taxes on banks.				
New Hampshire	Excluded (G, SB)	Excluded (G, SB)	Excluded (G, SB)	None	Sec. 77-A:4.
New Jersey	Banks are exempt from the corporate franchise tax on incomes				
New Mexico	Included (CB, OF)	Included (CB, OF)	Included (CB, OF)	Corporations do not pay taxes on the interest of any government obligations, United States, State, or local.	Secs. 72 15A-1 to 72-15A-15.
New York	Included (G)	Included (G)	Included (G)	None	Tax law, arts. 9A, 9B, 9C.
North Carolina	Excluded (CB, OF)	Included (CB, OF)	Included (CB, OF)	Interest on Federal obligations is excluded from the taxable income of corporations.	Secs. 105-228.15, 105-228.16.
North Dakota	Included (CB, OF)	do	do	Corporations do not include North Dakota State and local obligations nor U.S. Government obligations in their taxable income.	Sec. 57-35-02.
Ohio	There are no State income taxes. [7]				
Oklahoma	Included (CB, OF)	Included (CB, OF)	Included (CB, OF)	Corporations are exempt from paying taxes on U.S. Government obligations.	Sec. 2316, title 68, O.S.
Oregon	Included (G)	Included (G)	Included (G)	None	ORS 317.015.
Pennsylvania	Banks are not taxed on their income.				
Rhode Island	Included (CB, OF)	Included (CB, OF)	Included (CB, OF)	Corporations do not pay taxes on United States and Rhode Island State and local government obligations.	Secs. 44-14-13, 44-14-14.
South Carolina	do	do	do	Corporations are not taxed on United States and South Carolina State and local government obligations.	Rule BA-R-1.
South Dakota	do [9]	do	do	Corporations are not taxed on income	Art 2602-15.
Tennessee	Excluded (CB, OF)	do	do	None	Sec. 67-2701.
Texas	There is no income tax in Texas.				

See footnotes at end of table.

TABLE 20A.—TREATMENT OF INTEREST RECEIVED ON GOVERNMENTAL OBLIGATIONS AS AN ELEMENT IN STATE AND LOCAL TAXES MEASURED BY NET OR GROSS INCOME OF COMMERCIAL BANKS, JAN. 1, 1971—Continued

[CB—Commercial banks, State and national banks, OF—Other financial institutions, G—Corporations, generally, NB—National banks, SB—State banks]

State	State and local obligations of the taxing State	State and local obligations of other States	U.S. Government obligations	Differences from treatment of similar receipts of corporations	Reference to State revenue laws
(1)	(2)	(3)	(4)	(5)	(6)
Utah [9]	Included (CB, G)	Included (CB, G)	Included (CB, G)	None	Sec. 59-13-7.
Vermont [10]	(a) Excluded (G)	Excluded (G)	Excluded (G)	do	Sec. 5811.
	(b) Excluded (CB, OF)	Excluded (CB, OF)	Included (CB, OF)	U.S. Government obligations not included in corporate income tax.	Sec. 5836.
Virginia	Banks are exempt from income taxes.				
Washington	Excluded (G)	Included (G)	Included (G)	None	RCW 82.04.080, 82.04.432.
West Virginia	Banks are exempt from income taxes.				
Wisconsin	Included (G)	Included (G)	Included (G)	None	Secs. 71.01, 71.03.
Wyoming	There is no income tax on banks or corporations.				

[1] This entry reports the treatment of interest under the license tax on gross receipts.
[2] Included in the income base unless such interest has been specifically excluded by Colorado statutes.
[3] Only municipal revenue bonds are exempt.
[4] Certain State and local obligations are exempt from income tax under the laws of Kansas authorizing their issuance.
[5] If a State bank pays the franchise tax instead of the corporate income tax, the interest from obligations would follow (b) instead of (a).
[6] State banks pay both (a) the bank tax and (b) the corporate income tax.
[7] In Ohio, local governments impose income taxes, but provisions pertaining to banks vary.
[8] There are 1 or 2 exceptions where the interest from these obligations is exempt.
[9] Cols. 2, 3, and 4 are a composite of a franchise tax on corporations on their net income and a privilege tax on national banks. National banks pay only the privilege tax and State banks pay only the franchise tax.
[10] In Vermont, banks are subject to both a corporate net income tax (a) and a franchise tax on banking corporations (b). The amount the bank pays under the franchise tax is reduced by the amount it pays under the corporate income tax.

Source: Table compiled by Mrs. Arlene Lustig, Division of Research and Statistics, Federal Reserve Board, April 1971, from Commerce Clearing House, Inc., State tax reports for the several States.

Appellant's Reply Brief

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No. 81-1613

IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellant,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,
and
GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,
and
WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE,
Appellees.

Appeal From The Supreme Court Of Tennessee

REPLY BRIEF OF APPELLANT

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IN THE

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No. 81-1613

MEMPHIS BANK & TRUST COMPANY, *Appellant*,

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RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF
THE CITY OF MEMPHIS, TENNESSEE,

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WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE, *Appellees*.

Appeal From The Supreme Court Of Tennessee

REPLY BRIEF OF APPELLANT

Pursuant to Rule 35.3 of this Court's Rules, appellant submits this Reply to the brief filed by appellee William M. Leech, Jr., Attorney General of the State of Tennessee, and the brief filed by appellees Riley C. Garner, Shelby County Trustee, and Glenn E. Foster, Treasurer of the City of Memphis, Tennessee.

This case turns on the application of the federal exemption statute (31 U.S.C. § 742), and the related specific farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079, and 2134), which expressly exempt obligations of the United States and certain of its instrumentalities from taxation by States and their sub-

divisions. Under 31 U.S.C. § 742, "[t]his exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax. . . ." There can be no question that the Tennessee bank tax violates this general prohibition.

The federal exemption statute provides specific, limited exceptions to the general rule of exemption for "nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations" and for "estate taxes or inheritance taxes." Appellees have not shown that the Tennessee bank tax comes within any of these exceptions, as indeed it does not.[1]

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[1] Appellees Garner and Foster contend that the federal exemption statute (31 U.S.C. § 742) does not provide the only exceptions to the rule that federal obligations are exempt from taxation by the states; they suggest that 12 U.S.C. § 548 creates additional exceptions which somehow apply in this case. Garner and Foster's Brief at 6-9. That statute—both in its original form and as now in effect—plainly relates only to the taxation of national banks (Memphis Bank & Trust is not a national bank), but more importantly it makes no reference to federal obligations or the income therefrom; it is therefore irrelevant to this case. Moreover, the cases cited by appellees in support of their argument involve the distinction between state taxation of shareholders in a corporation and taxation of the corporation itself. The instant case clearly involves a tax on Memphis Bank & Trust, not on its shareholders. *See M'Culloch* v. *Maryland*, 17 U.S.(4 Wheat.) 316, 436-437 (1819), and *Society for Savings* v. *Bowers*, 349 U.S. 143 (1955). Furthermore, the discussion by appellees (including appellee Leech, Brief at 38) of the legislative history of an amendment to 12 U.S.C. § 548 adopted in 1969 is also irrelevant. Neither the amendment nor its legislative history in any way expands, contracts or overlaps with 31 U.S.C. § 742.

Finally, appellees rely on *Bank of Texas* v. *Childs*, 615 S.W.2d 810 (Tex. Civ. App. 1981), which is now before this Court on a writ of certiorari to the Supreme Court of Texas, *sub nom. American Bank*

I.

THE BANK TAX IS NOT A FRANCHISE TAX OR OTHER NONPROPERTY TAX IN LIEU THEREOF IMPOSED ON CORPORATIONS.

In an effort to demonstrate that the Tennessee bank tax is a franchise tax, appellees Garner and Foster (Brief at 11) quote from this Court's opinion in *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 145 (1911), in part as follows:

> "While the mere declaration contained in a statute that it shall be regarded as a tax of a particular character does not make it such if it is apparent that it cannot be so designated consistently with the meaning and effect of the act, *nevertheless the declaration of the lawmaking power is entitled to much weight*, and in this state the intention is expressly declared to impose a special excise tax with respect to the carrying on or doing business by such corporation . . ." Emphasis added.

They conclude from this that a reference in Tenn. Code Ann. §67-751 to the bank tax as an "excise tax" determines its status. Appellees further contend that the terms "excise" and "franchise" tax are interchangeable. Garner and Foster's Brief at 9; Leech's Brief at 11. They are wrong on both counts.

First, although a tax on the exercise of the privilege of doing business may well be in the form of an excise, not all

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& Trust Co. v. *Dallas County* (No. 81-1717). Appellees quote from the *Childs* case to suggest that the phrase "Except as otherwise provided by law," which appears in 31 U.S.C. § 742, provides a basis for referring to another statute, such as 12 U.S.C. § 548, to expand the exceptions provided under the federal exemption statute. Garner and Foster's Brief at 8. That phrase, however, inserted by the Revisers in the 1926 general revision of the Code, is not part of the statute and has not been enacted as law. *See* Brief of Appellant at 5 n.3.

excise taxes are franchise taxes. Of the four cases cited by appellee Leech for the proposition that this Court uses the terms interchangeably, the first, *Tradesmens National Bank* v. *Oklahoma Tax Commission*, 309 U.S. 560 (1940), does not even contain the word "excise." In the second case, *Pacific Co.* v. *Johnson*, 285 U.S. 480, 497-98 (1932), "excise" appears only in the dissenting opinion, and there only in its discussion of *Macallen Co.* v. *Massachusetts*, 279 U.S. 620 (1929), as a shorthand reference to the "excise upon the doing of business" at issue in that case. In *Educational Films Corp.* v. *Ward*, 282 U.S. 379, 389-91 (1931), this Court, after noting that *Flint* v. *Stone Tracy Co.* reaffirmed the validity of an excise "imposed on corporate franchises," went on to point out that there are other forms of excise taxes, including income, inheritance, and legacy taxes, the latter two of which obviously cannot be taxes on doing business in the corporate form. Moreover, Congress, which created the exception for nondiscriminatory franchise taxes in the federal exemption statute, clearly viewed an excise tax as a distinctly different type of tax. Compare, for example, the Federal excise tax on special fuels, 26 U.S.C. §4041, or the Federal estate tax (also an excise tax, *Estate of Purdy* v. *Eisner*, 256 U.S. 345 (1921)) on "the transfer of the taxable estate" (26 U.S.C. §2001). Similarly, the Tennessee legislature has enacted "excise" taxes which are not corporate franchise taxes, such as the "excise tax of ten cents (10¢) per gallon . . . imposed on the sale of motor vehicle fuel," which the statute requires be passed on by inclusion in the selling price of the fuel. Tenn. Code Ann. § 67-3703.

Second, appellees contend that the reference in the bank tax to an "excise tax" determines that it is a franchise tax within the meaning of the federal exemption statute. This contention ignores the repeated contrary

declarations in the bank tax itself—*e.g.*, it recites that it is imposed under specific constitutional authority to exact an intangible personal property tax; it creates a "subclassification of intangible personal property" of banks; and the property in that subclassification is thereupon taxed as provided. 1977 Tenn. Pub. Acts, ch. 140, § 1(A); Brief of Appellant at 5a.

Finally, in light of the weight to be given to "the declaration of the lawmaking power" under *Flint* v. *Stone Tracy Co.* it is important to note that the Tennessee bank tax—in sharp contrast to the state franchise tax and general corporate excise tax (Brief of Appellant at 8a and 10a)—does not once declare itself to be a franchise tax, a tax for the privilege of engaging in business in the corporate form, or a tax as compensation for the benefits received from doing business in Tennessee. Brief of Appellant at 5a. Moreover, the fact that the bank tax, though paid to local governments,[2] is imposed by the state in addition to and not in lieu of the state franchise tax indicates that it cannot also be a franchise tax. *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981).

Interestingly, appellee Leech (Brief at 10) cites *Educational Films Corp.* v. *Ward*, 282 U.S. 379 (1931), for the proposition that "[t]he nature of a tax must be determined by its operation rather than the descriptive language which may have been applied to it." Contrary to Leech's contention, however, the bank tax does not operate as a franchise tax. As demonstrated in Brief of Appellant at 16-18, it is levied as a tax on a "subclassification of in-

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[2] If the bank tax were a *local* tax, as urged by appellees (Leech's Brief at 10) and determined by the court below (J.A. 76a), it would necessarily be a property tax, since Tennessee law forbids the levying of any local franchise or excise tax, or any local tax similar to either. 1976 Tenn. Pub. Acts, ch. 537, §§ 4, 30.

tangible personal property;" it is exacted in conjunction with an alternative minimum *ad valorem* tax on the book value of the bank's shares; it was specifically enacted under authority of the Tennessee Constitution to tax intangible personal property; it is codified, unlike the franchise and general corporate excise taxes, in the same title and chapter as other direct taxes on corporate and business property; it is generally allocated between county and municipality on the basis of their respective property tax rates; and it is paid and collected pursuant to the same provisions as other property taxes. Indeed, the stipulation of the parties repeatedly (19 times) refers to the bank tax as an intangible personal property tax,[3] and as Garner and Foster admit (Brief at 12-13), the state Division of Property Assessments characterizes it as an intangible personal property tax.

II.

THE BANK TAX IS DISCRIMINATORY.

Whether it is deemed a franchise, property, income or other type of tax, the bank tax is discriminatory and thus violates 31 U.S.C. § 742. As Memphis Bank & Trust has demonstrated (Brief of Appellant at 18-23), a tax dis-

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[3] Contrary to Garner and Foster's suggestion (Brief at 2, 12), references in the stipulation to the intangible personal property tax were not qualified as the "contention of the appellant" or confined to "certain sums representing intangible personal property tax." It is repeatedly described simply as an "intangible personal property tax." ¶¶ 3, 4, 6, 7 and 8, J.A. 36a-40a.

Furthermore, the affidavit of David H. Wray, Personal Property Appraiser for the Division of Property Assessments of the State of Tennessee, filed below in the Chancery Court (Record at 56-65), repeatedly refers to the bank tax as an "intangible personal property tax" and contains therein appropriate state forms (Exhibits A, C and D) specificially captioned "Intangible Personal Property Tax Schedule for Banks" and "Banks Intangible Personal Property."

criminates against obligations of the United States if it imposes a higher tax on taxpayers who hold such obligations than on those who hold other assets. *Werner Machine Co.* v. *Director of Taxation*, 350 U.S. 492, 493-94 (1956); *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals*, 338 U.S. 665, 675 (1950); *Schuylkill Trust Co.* v. *Pennsylvania*, 296 U.S. 113, 119-20 (1935); *Commonwealth* v. *Curtis Publishing Co.*, 69 A.2d 410 (Pa. 1949), *cert. denied*, 339 U.S. 928 (1950). *See also Home Insurance Co.* v. *New York*, 134 U.S. 594, 601 (1890). Although appellees argue that the bank tax is not discriminatory, they do not—as indeed they cannot—avoid the simple fact that, in the instant case, interest from obligations of the United States is included in the measure of the tax while interest from obligations of the State of Tennessee and its political subdivisions is excluded.

Appellees contend that the test for discrimination is whether a tax "singles out" federal obligations for taxation (Garner and Foster's Brief at 4) or for "special treatment" (Leech's Brief at 7, 26). They rely, as did the court below, on *Miller* v. *Milwaukee*, 272 U.S. 713 (1928). Garner and Foster's Brief at 19-23; Leech's Brief at 17-36. That case, however, does not support their contention.

The tax at issue in *Miller* did not single out federal obligations for special treatment since income attributable to federal obligations was not the only income taxed. The case involved the Wisconsin income tax as it applied in 1922 (Bill of Complaint, ¶ III, *Miller* v. *Milwaukee*, *supra*, Transcript of Record, 1), which imposed a tax on *all* income (except as indicated below) received by every person, including both corporations and individuals, residing within the state. Wis. Stat. §§ 71.01, 71.02(1) (1921). Gross income was broadly defined and included dividends, interest, wages, and salaries, and "all other

gains, profits or income of any kind." Wis. Stat. § 71.02(2) (1921). Taxpayers—both corporate and individual—were allowed numerous deductions from gross income, including dividends received from corporations, but only to the extent those corporations were also subject to the tax. Wis. Stat. §§ 71.03, 71.04 (1921). Because the latter were not subject to tax on income from federal obligations, *inter alia*,[4] this had the effect of including dividends attributable to income from federal obligations and other exempt income in the base of the tax of individual and corporate taxpayers. Thus, like the Tennessee bank tax, income attributable to interest on federal obligations (*i.e.*, dividends attributable to income not subject to tax at the corporate level) was not "singled out" as the only income taxed at the shareholder level, but was included, with "all other gains, profits or income of any kind," in gross income.[5]

The *Miller* case, in fact, supports the principle that a tax must be regarded as discriminatory if it imposes a higher tax on taxpayers who hold federal obligations than on those who hold other assets, and is thus consistent with this Court's decisions in *Werner Machine Co.* and *Schuylkill Trust Co. See* Brief of Appellant at 18-23, and cases cited therein. That principle is clearly reflected in Mr. Justice Holmes' hypothetical in *Miller* that, while "[a] system of taxation that applied to stockholders of all corporations equally might tax . . . the stockholders of a

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[4] In addition to income from bonds of the United States, which was "of course" exempt from tax in the hands of the corporation paying the dividends (*Miller* v. *Milwaukee*, 272 U.S. at 714), a number of other types of income were exempt as well. Wis. Stat. § 71.05 (1921).

[5] Garner and Foster (Brief at 21) are thus incorrect in their argument, drawn in part from language found in *Pacific Co.* v. *Johnson*, 285 U.S. 480, 493-94 (1932), that income from federal bonds was taxed and all other income was excluded.

corporation that had invested all its property in United States bonds," a tax which taxed only shareholders of corporations holding only United States bonds would obviously be invalid. 272 U.S. at 714-15.

Although in Mr. Justice Holmes' example the only income taxed was dividends paid by corporations out of income from federal obligations, the actual fact in *Miller* was that shareholders were taxed on such dividends as well as dividends from corporations outside Wisconsin and all other types of income. The point is that a taxpayer who derived income from federal obligations (*i.e.*, indirectly, through dividends from a corporation owning such obligations) would pay a greater tax than a taxpayer who received an equal amount of dividends from a corporation with income derived from other sources.

This Court has further made clear as recently as 1960 in *Phillips Co.* v. *Dumas School District*, 361 U.S. 376 (1960), that a tax need not "single out" the federal government as an object of taxation in order to be regarded as discriminatory. In *Phillips Co.* the Court invalidated a state tax imposed on a lessee of federal land where, as the Court was careful to point out, an equivalent tax burden applied to lessees of private, *but not state*, lands. 361 U.S. at 381. In invalidating the tax, the Court stated:

> "[T]he State and the School District concede that Phillips would not be taxed at all if its lessor were the State or one of its political subdivisions instead of the Federal Government . . . [I]t does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself." 361 U.S. at 382-385.

This is precisely the situation in the present case.

Appellees next argue, again relying on *Miller*, that the Tennessee bank tax is not invalid since neither its

"avowed purpose" nor its "self-evident operation" is to tax income from federal obligations. Leech's Brief at 19; Garner and Foster's Brief at 19. Although not necessary to a finding of discrimination, it nevertheless appears that the bank tax was deliberately designed to follow and tax federal obligations. The "purpose" of a statute is the "result intelligently foreseen and offering the most obvious motive for an act that will bring it about. . . ." *Miller* v. *Milwaukee*, 272 U.S. at 715. The Tennessee legislature was clearly aware in adopting the definition of net earnings subject to tax (incorporated by reference in the bank tax) that it was including "all interest and dividends from federal, state, county, municipal and other securities except those of the State of Tennessee and its political subdivisions." Final Report of the Committee to Study the Franchise and Excise Taxes, 31 (January 1976) (relating to the general corporate franchise and excise taxes). Just as in *Miller*, where dividends attributable to interest on federal obligations were taxed while dividends attributable to certain other income were not, the "self-evident operation" of the Tennessee bank tax is "to follow the bonds of the United States."

Lastly, appellees argue, once again citing *Miller*, that the "true" definition of a discriminatory tax is a tax "aimed at"—by which they appear to mean a tax which seeks out or specifically intends to reach—federal obligations, rather than a tax which has only a "casual effect" on them. Garner and Foster's Brief at 4, 22-23. Appellees' interpretation of *Miller* and its use of the phrase "aimed at" is essentially the same interpretation employed in *Macallen* v. *Massachusetts*, 279 U.S. 620, 630-33 (1929). Although appellees concede that *Macallen* has been substantially impaired by subsequent cases, *see, e.g.*, *United States* v. *City of Detroit*, 355 U.S. 466, 472 n.2 (1958), they fail to acknowledge that their own argument has been thereby undermined as well.

In *Macallen* a state corporate franchise tax was amended to include interest on federal obligations in the income by which the tax was measured. This Court found that the amendment was specifically intended to subject federal obligations *pro tanto* to the burden of the tax and, relying on the *Miller* opinion, held the tax invalid. 279 U.S. at 630-33. In refusing to follow *Macallen*, later cases have noted that the tax there was not discriminatory since interest on federal obligations was included in the tax the same as other income. *Tradesmens Nat. Bank* v. *Oklahoma Tax Commission*, 309 U.S. 560, 566 (1940); *Pacific Co.* v. *Johnson*, 285 U.S. 480, 494 (1932).[6]

Under *Miller*, a tax is *aimed* at federal obligations where it *discriminates* against them and a tax cannot be deemed to have a "casual effect" on such obligations where it is discriminatory. Thus, the common thread running through *Miller*, *Werner Machine Co.* and *Schuylkill Trust Co.* is that a tax is discriminatory if it imposes a higher tax on taxpayers who hold federal obligations than on those who hold other assets.

Appellees next turn to *Schuylkill Trust Co.* and attempt to discredit it on several grounds.

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[6] In *Pacific Co.* v. *Johnson*, 285 U.S. 480, 492-93 (1932), which involved a California corporate franchise tax measured by net income, including interest from federal, state and municipal bonds, the Court agreed with the taxpayer that in adopting the tax in issue, the legislature had a "definite and specific legislative purpose" to include tax exempt income from federal and state bonds in a franchise tax measured by net income. Nevertheless, the Court upheld the tax, noting:

> "Since the mere intent of the Legislature to do that which the Constitution permits cannot deprive legislation of its constitutional validity, . . . the present act must be judged by its operation rather than by the motives which inspired it. As it operates to measure the tax on the corporate franchise by the entire net income of the corporation, *without any discrimination between income which is exempt and that which is not*, there is no infringement of any constitutional immunity." 285 U.S. at 495-96. Emphasis added.

Although Leech (Brief at 22) concedes that the tax in *Schuylkill Trust Co.* was discriminatory because it placed a higher burden on taxpayers holding federal obligations than on those holding other assets, he asserts that the decision there has been limited to its facts. He cites no authority for his assertion and, further, overlooks the fact that *Schuylkill* has been cited with approval by this Court as recently as 1965 in *United States* v. *Atlas Life Insurance Co.*, 381 U.S. 233, 245 n. 15 (1965).[7]

Further, in criticizing *Schuylkill*, Leech alleges (Brief at 22) that the Court confused the issue of whether the tax was a direct tax on federal obligations with the issue of whether there was discrimination. He also suggests (Brief at 23) that *Schuylkill* is wrong because the tax was an indirect shares tax and valid under the test applied in *Society for Savings* v. *Bowers*, 349 U.S. 143 (1955). Garner and Foster similarly contend (Brief at 21) that *Schuylkill* is distinguishable from the instant case because it involved a property tax rather than a franchise tax. However, it is clear from the federal exemption statute that a tax which discriminates against federal obligations, whether it is a direct or indirect tax, is invalid. Thus, as the Court in *Schuylkill* said, "the issue of discrimination is not to be resolved by a choice between the two contentions as to the nature of the tax." 296 U.S. at 120.

In addition, Leech argues (Brief at 23) that the precedential value of *Schuylkill* is limited because in that case the Court concluded that there was a direct burden

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[7] Even more recently, *Schuylkill Trust Co.* v. *Pennsylvania*, 296 U.S. 113 (1935), was applied in *National Bank of Alaska* v. *Department of Revenue*, 642 P.2d 811, 818 (Alaska 1982) (a state tax which includes interest from federal obligations in net income and excludes interest on certain state obligations would be discriminatory and thus invalid).

on federal obligations.[8] He incorrectly contends that this direct burden rationale has been replaced. Leech's Brief at 24. Indeed, the continuing validity of the direct burden principle in *Schuylkill* is demonstrated in a line of recent cases dealing with the general authority of the states to tax and the sovereignty of the United States and its instrumentalities, in which the test for discrimination is whether the tax is imposed equally on similarly situated taxpayers or places a greater tax burden on the federal government or those with whom it does business. *United States* v. *County of Fresno*, 429 U.S. 452, 462 (1977); *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744, 751 (1961); *Phillips Co.* v. *Dumas School District*, 361 U.S. 376, 382-387 (1960); *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 494-495 (1958). Moreover, the *Werner Machine* case, 350 U.S. 492 (1956), which Leech says has limited *Schuylkill*, emphasizes to the contrary that:

> "Since [in *Werner*, unlike *Schyulkill* and the present case] the tax remains the same whatever the character of the corporate assets may be, no claim can be sustained that this taxing statute discriminates against the federal obligations." 350 U.S. at 493.

Appellees also seek to discredit *Schuylkill* by arguing that it is inconsistent with other opinions of this Court, including, for example, *Flint* v. *Stone Tracy Co.*, 220 U.S. 107 (1911) (Garner and Foster's Brief at 19, 22), in which a tax measured by net income was upheld where an

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[8] This conclusion does not mean that the Court determined the tax to be a direct property tax on those obligations, but is simply consistent with the principle that a discriminatory tax (such as the tax in *Schuylkill*, which exempted securities of state corporations from its measure while denying such exemption to federal government securities and those issued by federal instrumentalities, just as the Tennessee bank tax, which includes income from obligations of the United States and its instrumentalities in its measure but excludes income from obligations of Tennessee and its subdivisions), whether direct or indirect, places a direct burden on the federal obligations.

express deduction for dividends received from corporate stock was allowed but no deduction was permitted for income from federal obligations. However, the tax at issue in that case was a federal tax and the issue of unconstitutional discrimination against federal obligations by a state tax was obviously not present; in any event, the only income exempted from tax was dividend income already subjected to the same corporate tax.[9] Appellees also suggest that *Schuylkill* is inconsistent with *Tradesmens National Bank* v. *Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940) (Leech's Brief at 23-24); and *Mercantile National Bank* v. *New York*, 121 U.S. 138 (1887) and *South Broadway National Bank* v. *City & County of Denver*, 51 F.2d 703 (10th Cir. 1931). Garner and Foster's Brief at 24. However, the cited portions of all three of these cases deal only with the application of 12 U.S.C. § 548 (and its predecessors) to taxes on national banks and not whether those taxes discriminated against federal obligations.

Having thus failed to discredit *Schuylkill*, appellee Leech nevertheless urges this Court to adopt a new definition of discrimination, one he draws from the dissenting opinion in *Schuylkill*. Leech's Brief at 30. In the nearly 50 years since *Schuylkill*, this Court has shown no inclination to reverse itself and adopt the dissenting opinion, to which it has never even referred.[10]

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[9] Unlike *Miller* 16 years later, no distinction was made in the tax in *Flint* v. *Stone Tracy Co.* between dividends attributable to interest from exempt obligations and dividends from other sources.

[10] Leech also contends that for discrimination to be present, federal obligations must be subject to a higher *rate* of tax and that the Tennessee bank tax taxes all items of *taxable* income equally. Leech's Brief at 26-27. However, the necessity of a generally higher rate of tax on federal obligations to establish discrimination is not borne out by the authorities, including *Schuylkill*, which requires only a higher

Appellees erroneously argue (Leech's Brief at 28-29; Garner and Foster's Brief at 24-25) that in order for Memphis Bank & Trust to prevail it must show that the bank tax renders federal obligations less attractive than Tennessee obligations and, further, that Tennessee bonds "compete substantially" with federal obligations. Clearly no such proof is required. Once again, appellees rely on the dissenting opinion in *Schuylkill* and cite no case (and we can find none) in which such proof was required. Moreover, it is clear that in determining the value of a debt obligation, the free market takes into account such factors as the risk involved, the term of the obligation, the interest rate, and the rate of return *after all taxes*. Thus, although two different obligations cannot be equivalent, different tax rates on income from two different obligations will affect the market for each.[11]

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tax on a taxpayer holding federal obligations. *See also, Miller* v. *Milwaukee*, 272 U.S. 713 (1928), and *Phillips Co.* v. *Dumas School District*, 361 U.S. 376 (1960), in which, contrary to Leech's contention (Brief at 27 n. 2), lessees of the federal government bore a tax burden at the same rate as lessees of private property. 361 U.S. at 381. In any event, under the bank tax the rate on interest from federal obligations *is* higher than on interest from state obligations, which is excluded from taxable income altogether and therefore subject to a zero rate of tax.

[11] Leech's attempt (Brief at 35 n.5) to show that the bank tax does not have a significant impact on an investor's decision to buy state bonds fails entirely. His computation is based on a long series of erroneous estimates and assumptions and not on interest rates and investments actually available to the bank or actual expenses related to such investments. Moreover, the impact of the bank tax must be significant since the Government of the United States calculates that if all states imposed similar bank taxes, the United States would incur additional borrowing costs of approximately $280 million. Brief for the United States as *Amicus Curiae* Supporting Reversal at 2.

In any event, the magnitude of the impact of the Tennessee bank tax on federal obligations is not important since the purpose of the

Appellees make no reference in their briefs to the case of *Commonwealth* v. *Curtis Publishing Co.*, 69 A.2d 410 (Pa. 1949), *cert. denied*, 339 U.S. 928 (1950), addressed at length in Brief of Appellant at 20-21, where the Supreme Court of Pennsylvania applied, on facts strikingly similar to those here, precisely the same test for discrimination urged now by Memphis Bank & Trust. Nor have appellees noted the recent decision of the Supreme Court of Alaska, *National Bank of Alaska* v. *Department of Revenue*, 642 P.2d 811 (Alaska 1982), where, again, a state supreme court has applied this Court's decision in *Schuylkill Trust Co.* to hold that a state tax statute could not include in its measure income from federal obligations while excluding income from state obligations. The court there stated: "An unlawful tax discrimination problem arises when federal securities are accorded less favorable treatment by state laws than is given to state or private securities." 642 P.2d at 818. The decision of the Supreme Court of Tennessee that the bank tax is not discriminatory should therefore be reversed.

III.

THE BANK TAX VIOLATES 12 U.S.C. §§ 2055, 2079 AND 2134.

Faced with the uncompromising language of the federal farm credit agency exemption statutes, appellees have been unable to demonstrate the validity of the Tennessee bank tax, which includes in its measure income from

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exemption statute is "to prevent taxes which diminish *in the slightest degree* the market value or investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals*, 338 U.S. 665, 675 (1950), quoting *Smith* v. *Davis*, 323 U.S. 111, 117 (1944). Emphasis added. Furthermore, a state tax is invalid if, "[t]o any extent, however inconsiderable, it is a burden on the operations of government." *Weston* v. *City Council of Charleston*, 27 U.S. (2 Pet.) 449, 468 (1829).

obligations of federal farm credit agencies and indeed, as demonstrated above, discriminates against such obligations. Although Garner and Foster argue (Brief at 26) that a state tax on federal farm credit agency obligations does not impede the borrowing power of the United States, that is not the issue here. It is clear that the federal farm credit agency exemption statutes are designed to give effect to the valid Congressional purpose of providing loans for agricultural purposes at the lowest possible interest rates (*See* Brief of Appellant at 24; Brief of Farm Credit Banks in Support of Appellant at 4, 8-11), and, as this Court has made clear, whatever the nature of the ownership of farm credit system banks, Congress has authority to exempt them and their obligations from tax. *Smith* v. *Kansas City Title & Trust Co.*, 225 U.S. 180 (1921).

The Supreme Court of Montana recently held invalid a tax which, like the Tennessee bank tax, included interest on federal farm credit agency obligations in its measure. *First Federal Savings and Loan Assoc.* v. *Department of Revenue*, No. 81-258 (Supreme Court of Montana, Sept. 23, 1982). In that case Montana imposed a 6-3/4% license fee on the taxpayers' net income for the privilege of doing business, and the Department of Revenue refused to allow taxpayers a deduction from gross income for interest received from government obligations, 94% of which was from federal farm credit agency notes, securities, obligations and stock. After noting that the specific federal agency exemption statutes, including the three cited above, "expressly provide that the principal and interest of the various federal obligations are exempt from all state taxation except certain taxes not relevant," and after considering the argument of the Department of Revenue that the tax in issue was a franchise tax (*First Federal Savings & Loan Assoc.*, No. 81-258, slip op. at 6), the court concluded that the interest income could not be

included in net income for determining the amount of the license tax. With respect to the opinion of the court below in the instant case, the court stated:

> "We disagree with the Tennessee court. It is our opinion that both the general federal exemption statute and the individual particular federal exemption statutes clearly exempt the interest income of the federal obligations involved in the instant case from the Montana Corporation License Tax." Slip Op. at 8.

Like the license tax in the Montana case, the Tennessee bank tax violates the federal farm credit agency exemption statutes.

IV.

THE BANK TAX IS UNCONSTITUTIONAL AS APPLIED TO MEMPHIS BANK & TRUST.

Appellees Garner and Foster state that Memphis Bank & Trust "has walked a technical tightrope on the issue of constitutionality of the Tennessee Bank Tax." Garner and Foster's Brief at 27. They complain that Memphis Bank & Trust has at various times taken the position that the bank tax is unconstitutional on its face and in its entirety and, at other times, has argued that the bank tax is unconstitutional only as applied to it. *Id.* Their argument is frivolous and unfounded.

Memphis Bank & Trust has consistently contended throughout this case that the bank tax is unconstitutional as applied to it, and violates the federal exemption statute (31 U.S.C. § 742) and the federal farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134), insofar as it includes obligations of the United States and its instrumentalities, or the interest thereon, in the computation of the tax. *See* J.A. 8a-12a, 18a-19a, 27a-31a.

Appellees Garner and Foster contend (Brief at 27-29) that Memphis Bank & Trust has failed to advance any theory under which, if it prevails, any portion of the bank tax could be "exorcised" from the statute. Memphis Bank & Trust, however, does not seek a judicial redrafting of the statute, but only a determination that the inclusion of interest on federal obligations in the measure of the bank tax is invalid. *See, e.g.*, Brief of Appellant at 26. Furthermore, the act enacting the bank tax specifically provides that any unconstitutional or invalid portion of the statute may be severed and the remaining portions given effect. 1977 Tenn. Pub. Acts, ch. 140, §9.

Appellees Garner and Foster (Brief at 29-30) also argue that if the present bank tax is invalid, the bank tax in effect before its enactment (Tenn. Code Ann. §.67-715, *et seq.* (1976)) should be revived to replace it. This Court need not reach that issue, however, since, as noted above, Memphis Bank & Trust does not argue that the bank tax is unconstitutional on its face or in its entirety, but only to the extent it includes interest from obligations of the United States and its instrumentalities in the measure of the tax.[12]

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[12] In his Brief for the United States as *Amicus Curiae* Supporting Reversal, pages 11-12, the Solicitor General suggests that this Court consider remanding the case for consideration of issues involving the operation of the minimum tax provisions of the bank tax, Tenn. Code Ann. § 67-752. However, as appellee Leech notes (Brief at 14-15), the alternative minimum tax is not an issue in this case. The parties have stipulated that no bank tax would be owing if the income in question was deducted from Memphis Bank & Trust's gross income (J.A. 39a-40a) and there can be no minimum tax owing. The minimum tax calculation for 1978, contained in the affadavit of David H. Wray, Personal Property Appraiser for the Division of Property Assessments of the State of Tennessee (Record at 64), shows a zero minimum tax.

CONCLUSION

For the reasons set forth in the Brief of Appellant and in this Reply Brief, this Court should reverse the judgment of the Supreme Court of Tennessee and hold that the Tennessee bank tax, as applied to Memphis Bank & Trust, is unconstitutional and violates the federal exemption statute (31 U.S.C. § 742) and the federal farm credit agency exemption statutes (12 U.S.C. §§ 2055, 2079 and 2134), insofar as it includes obligations of the United States and its instrumentalities, or the interest thereon, in the computation of the tax.

Respectfully submitted,

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MOTION FILED
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No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellants,

v.

RILEY C. GARNER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE, AND WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,
Appellees.

On Appeal from the Supreme Court of Tennessee

MOTION FOR LEAVE TO FILE AMICI CURIAE BRIEF AND BRIEF FOR CAPITAL PRESERVATION FUND, INC. AND SANDRA L. BROWN AS AMICI CURIAE

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MOTION FOR LEAVE TO FILE AMICI CURIAE BRIEF

Capital Preservation Fund, Inc., a regulated investment company that is organized under the laws of California, and Sandra L. Brown respectfully move this Court for leave to file the accompanying brief as amici curiae. Applicants requested, but were unable to obtain the consent of all of the parties to this action to file the accompanying brief.

Applicants have an interest in this case in that they are presently preparing to initiate an administrative challenge to California Revenue and Taxation Code section 17137.5 before the California Franchise Tax Board, which will raise the same

issue as that presented for decision in the instant case—whether a state may impose a tax on the income derived from United States obligations while exempting from equivalent taxation the income derived from its own state or local credit instruments.

In its brief submitted to the Supreme Court of Tennessee, Appellant herein argued that the Tennessee bank excise tax at issue in this case unlawfully discriminated against the United States, but the discussion therein of this point was inadequate in that Appellant's brief was directed primarily to the argument that the Tennessee bank excise tax is an unlawful discrimination against banks. After conversation between counsel for applicants and counsel for Appellant, applicants have no reason to believe that Appellant will expand and make complete in this Court its argument that the Tennessee bank excise tax unlawfully discriminates against the United States and its investors. If applicants' argument is approved by this Court, the decision of the Supreme Court of Tennessee below must be reversed.

DATED: July 8, 1982.

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No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY,
Appellants,

v.

RILEY C. GARNER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE, AND WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE,
Appellees.

On Appeal from the Supreme Court of Tennessee

BRIEF FOR CAPITAL PRESERVATION FUND, INC. AND SANDRA L. BROWN AS AMICI CURIAE

INTEREST OF AMICI CURIAE

Amicus curiae, Capital Preservation Fund, Inc. ("Capital Preservation") is a regulated investment company,[1] which is organized under the laws of California and operates as an investment fund for private investor/shareholders. Capital

[1] Capital Preservation is subject to regulation under the Investment Company Act of 1940. 15 U.S.C. §80a-3. Capital Preservation is also a "diversified management company" as defined by section 23701m of the California Revenue and Taxation Code.

Preservation, with assets of approximately two billion dollars, invests exclusively in United States Treasury credit instruments. As a regulated investment company, Capital Preservation does not pay federal income taxes on income from its investments according to the rules applicable to most corporations. Instead, and subject to various regulations, dividend and interest income from Capital Preservation's investments is not taxed if it is distributed during the current tax year to its investor/shareholders. *See* I.R.C. §§851 & 852. The dividends that Capital Preservation pays to its shareholders, which are then reported as gross taxable income on the shareholders' own federal tax returns, include the interest income that Capital Preservation receives from its investments in United States Treasury credit instruments. Amicus curiae Sandra L. Brown is one of these shareholders.

Amici curiae have filed this brief on behalf of Appellant Memphis Bank and Trust Company because, like Appellant, their state of residence enforces laws that unconstitutionally discriminate against them on the basis of their decision to invest in United States obligations. The issue presented by this appeal is whether Tennessee may impose on national banks that operate within its jurisdiction an excise tax, which is measured by income of the bank that includes interest from federal bonds but excludes interest from bonds issued by Tennessee or its political subdivisions.[2]

Amici curiae soon will challenge a California tax that, like the Tennessee bank excise tax, diminishes the investment attractiveness of federal credit instruments vis-a-vis state and local obligations. The discriminatory California taxing scheme is embodied in section 17137.5 of the California Revenue and Taxation Code. Section 17137.5 provides that if a diversified management company, such as Capital Preservation, invests more than fifty percent of the value of its assets in bonds issued by California or its local subdivisions, the shareholders of the company may exclude from their taxable income the dividend

[2] Tennessee does include in the measurement of its excise tax income from bonds of other states and bonds issued by municipalities outside of Tennessee. *See* note 3 *infra*.

distributions received from the company. Thus, if Capital Preservation invested more than fifty percent of the value of its assets in California state or local bonds, instead of in federal obligations, the dividends paid to its shareholders, such as Sandra Brown, would be excluded from the shareholders' taxable incomes.

In the following pages, amici curiae will argue that the United States Constitution and 31 U.S.C. §742, as interpreted by a long and uniform line of decisions of this Court, render unlawful the kind of discrimination encountered by the Memphis Bank and Trust Company in Tennessee and by amici in California. Both states favor taxpayers who derive income from state and local government credit instruments over taxpayers who earn income from obligations marketed by the United States. This kind of discrimination subverts long-standing principles of intergovernmental immunity and may seriously impair the ability of the United States to finance the public debt. If the states are permitted to enhance the marketability of their bonds vis-a-vis the obligations of the United States, the federal government will be disadvantaged in the competition for investors in the general market for government credit instruments. The impact of this disadvantage would be increased each time another state determined to add a law similar to that of Tennessee or to interpret an existing law to its own advantage. Thus, because the issue before the Court in this case is an important one that affects amici as investors in United States obligations, and because amici curiae believe that the Tennessee bank excise tax is unconstitutional, they present this brief on behalf of Appellant, Memphis Bank and Trust Company.

SUMMARY OF ARGUMENT

Throughout this nation's history, the Court has recognized two principles of federal tax immunity. First, a state may not directly tax the United States or its instrumentalities. Second, a state tax on a person or entity that conducts business with the United States may be constitutional only if the tax does not discriminate, either directly or indirectly, against the federal government. Midway through the nineteenth century, Congress

codified these principles with respect to federal bonds and other securities, providing that the income derived from federal obligations may not be taxed by the states. Congress excepted from this rule state franchise taxes on corporations, if those taxes are imposed on a nondiscriminatory basis.

The decision of the Tennessee Supreme Court below interpreted the Tennessee bank excise tax, which is computed on the income earned by national banks in Tennessee, as being a nondiscriminatory franchise tax. Examination of the operation of that tax reveals, however, that Tennessee discriminates in favor of its own state and local bonds to the detriment of federal obligations by exempting from the computation of the excise tax income derived from the former while including in the measurement income from the latter. This is precisely the kind of discrimination that Congress prohibited in the mid-nineteenth century and that this Court has consistently declared to be unconstitutional. Finally, because a number of states have tax schemes that are similar to Tennessee's, the Court's resolution of this case is of great national importance. If the states collectively may favor their own credit instruments over competing federal obligations, the ability of the United States to fund the public debt may be seriously impaired. For the foregoing reasons, the judgment of the Tennessee Supreme Court below is incorrect and should be reversed.

ARGUMENT

THE TENNESSEE BANK EXCISE TAX DISCRIMINATES AGAINST THE FEDERAL GOVERNMENT AND THEREFORE IS UNCONSTITUTIONAL.

A. The Evolution of Federal Immunity From State Taxation and the Enduring Principle of Nondiscrimination.

Since *M'Culloch* v. *Maryland*, 4 Wheat. 316 (1819), it has been well-settled that a state may not, consistent with the Constitution, levy a tax directly against the United States or its instrumentalities. Nor may a state discriminate against the United States when it taxes private persons or entities that transact business with the federal government. These principles of federal tax immunity arise out of the constitutional grant of

power to the Congress "[t]o borrow Money on the credit of the United States" (U.S. Const. art. I, §8, cl. 2) and the Supremacy Clause. *Id.*, art. VI. cl. 2.

Following *M'Culloch*, the Court gradually extended the scope of the federal immunity doctrine to cover virtually all persons who conducted business with the United States, exempting from state taxation the income derived from such dealings even though the state tax applied equally to similarly situated persons who had not dealt with the United States. *See, e.g., Dobbins* v. *Commissioners*, 16 Pet. 435 (1842) (state income tax unconstitutional as applied to income from federal employment); *Gillespie* v. *Oklahoma*, 257 U.S. 501 (1922) (state income tax on profits earned by private business on Indian lands leased from federal government unconstitutional); *Long* v. *Rockwood*, 277 U.S. 142 (1928) (state may not apply general income tax to income from royalties derived from patents granted to private party by United States); *Panhandle Oil Co.* v. *Mississippi ex rel. Knox*, 277 U.S. 218 (1928) (state sales tax invalid as applied to sales by private company to United States). As this Court has recognized recently, the extended federal immunity decisions "were increasingly divorced both from the constitutional foundations of the immunity doctrine and from 'the actual workings of our federalism.'" *United States* v. *New Mexico*, 50 U.S.L.W. 4326, 4329 (U.S. March 24, 1982) (quoting *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466, 490 (1939) (Frankfurter, J., concurring)). Accordingly, beginning in 1937, the Court has curtailed the ability of private parties to claim federal immunity from state taxation so that today, in order "to resist the State's taxing power, a private taxpayer must actually 'stand in the Government's shoes.'" *United States* v. *New Mexico*, 50 U.S.L.W. at 4330 (quoting *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 503 (1958) (opinion of Frankfurter, J.)); *see id.* at 4329-30 and cases discussed therein.

Although the prohibition against state taxation of persons who conduct business with the United States has gone through many permutations, and its early development has now been pruned back to its historical origins, the Court has been

unwavering in its adherence to the principle that a state may not levy a tax on a private entity if the tax directly or indirectly discriminates against the United States. Indeed, in every case since 1937 in which it has reduced the scope of federal tax immunity with respect to private taxpayers, the Court has been careful to point out that the state tax in question applied not only to the taxpayers before the Court, but also to all similarly situated taxpayers who did not deal with the federal government.

In *James* v. *Dravo Contracting Co.*, 302 U.S. 134 (1937), for example, the Court upheld a West Virginia gross receipts tax as applied to a construction company's income from contracts with the United States. The tax was levied equally, however, on " 'every person engaging or continuing within this State in the business of contracting.' " *Id.* at 138 (quoting W. Va. Code, ch. 11, art. 3 (1931), *amended effective* May 27, 1933). As Chief Justice Hughes observed for the majority, "The tax is non-discriminatory." *Id.* at 149. In *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466 (1939), the Court sustained the state's application of its income tax to employees of the federal Home Owners' Loan Corporation. Writing for the Court, Justice Stone noted that the tax was "a non-discriminatory tax on income applied to salaries at a specified rate." 306 U.S. at 480. Similarly, the Alabama sales and use taxes upheld in *Alabama* v. *King & Boozer*, 314 U.S. 1 (1941), and *Curry* v. *United States*, 314 U.S. 14 (1941), applied respectively "to sales of building materials to contractors" generally and to "[e]very person storing, using or otherwise consuming in this State, tangible personal property." *King & Boozer*, 314 U.S. at 7 (quoting 1931 Ala. Acts 18, §I(j)); *Curry*, 314 U.S. at 16 (quoting 1939 Ala. Acts 67, §II(b)). In *King & Boozer*, the Court expressly declared the statute to be "a nondiscriminatory state tax upon the contractor" (314 U.S. at 8); and in *Curry*, the Court concluded its opinion with the caveat that it was deciding "only the question passed upon by the Supreme Court of Alabama, that if the statute is applicable to and taxes the contractors upon a cost-plus contract like the present, if entered into with a private person, they are not immune from the tax when, as here, the contract is with the Government." 314 U.S. at 18.

The Court's more recent opinions in this area are no less emphatic that to pass constitutional muster a state tax must be nondiscriminatory. At issue in *United States* v. *City of Detroit*, 355 U.S. 466 (1958), was the constitutionality of applying a Michigan tax statute to a lessee of United States property. The statute provided that if tax-exempt real property were used by a private party in a business for profit, the private party would be taxed to the same extent as though he owned the property. The Court upheld the statute and noted specifically that the tax was nondiscriminatory:

> "It still remains true, as it has from the beginning, that a tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the Government or those with whom it deals. Cf. *M'Culloch* v. *Maryland* (US) 4 Wheat 316. But here the tax applies to every private party who uses exempt property in Michigan in connection with a business conducted for private gain. Under Michigan law this means persons who use property owned by the Federal Government, the State, its political subdivisions, churches, charitable organizations and a great host of other entities." *Id.* at 473 (footnote omitted).

In a companion case, *City of Detroit* v. *Murray Corp.*, 355 U.S. 489 (1958), the Court observed that "[t]here is no claim that the challenged taxes discriminate against persons holding government property. To the contrary the tax is a general tax which applies and has been applied throughout the State." *Id.* at 494.

Likewise, in *United States* v. *County of Fresno*, 429 U.S. 452 (1977), the Court sustained the application of California's annual use or property tax on possessors of improvements on tax-exempt land to employees of the United States Forest Service who lived in federally owned houses in the national forests. The tax applied equally to users of nonfederal tax-exempt property. *Id.* at 464. Moreover, California imposed a property tax on owners of nonexempt property, which would be passed on by them to their lessees. "Consequently," concluded the Court, "the appellants who rent from the Forest Service are

no worse off under California tax laws than those who work for private employers and rent houses in the private sector." *Id.* at 465.

Finally, and most recently, in *United States* v. *New Mexico*, 50 U.S.L.W. 4326 (U.S. March 24, 1982), the Court was careful to note that New Mexico's use, gross receipts, and sales taxes applied equally to all businesses that operate in the state. *Id.* at 4330 n.11. The Court stated that "[i]t remains true, of course, that state taxes on contractors are constitutionally invalid if they discriminate against the Federal Government, or substantially interfere with its activities." *Id.*

The Court's consistent reference to this principle is not mere windowdressing. When there has been a discrimination that affects the federal government, the Court has not hesitated to declare the state tax unconstitutional. Two cases decided during the early 1960s struck down state taxes precisely because they discriminated against nongovernmental entities that did business with the United States. In *Phillips Chemical Co.* v. *Dumas Independent School District*, 361 U.S. 376 (1960), a lessee of United States property challenged Texas' ad valorem property tax, claiming that it was higher than the property tax levied against lessees of tax-exempt property owned by the state and its local governmental agencies. The Court found that the Texas tax scheme imposed "a distinctly lesser burden on similarly situated lessees of exempt property owned by the State and its political subdivisions." *Id.* at 379. Indeed, Texas had conceded that the taxpayer before the Court would not have been "taxed at all if its lessor were the State or one of its political subdivisions instead of the Federal Government." *Id.* at 382. Rejecting Texas' argument that the tax must be upheld " 'if any state of facts reasonably can be conceived that would sustain it' " (*id.* at 383), the Court unanimously invalidated the statute. *Id.* at 387. The Court declared that, "it still remains true, as it has from the time of *M'Culloch* v. *Maryland* (U.S.) 4 Wheat 316, that a state tax may not discriminate against the Government or those with whom it deals." *Id.* In *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744 (1961), also a

unanimous decision, the Court struck down a Washington ad valorem property tax levied against lessees of federal property. Finding that the tax imposed on the leasehold interests in question was higher than that applied to lessees of similar nonfederal property, including the state's own tax-exempt property (*id.* at 749), the Court concluded, "If anything is settled in the law, it is that a State may not discriminate against the Federal Government or its lessees." *Id.* at 751.

In sum, although the scope of federal immunity from state taxation for private taxpayers has gone through many changes since *M'Culloch,* two principles have remained constant. First, as the Court stated in *New Mexico,* "a State may not, consistent with the Supremacy Clause . . . lay a tax 'directly upon the United States.' " 50 U.S.L.W. at 4330 (quoting *Mayo* v. *United States,* 319 U.S. 441, 447 (1943)). Second, if a state tax is levied on a party who conducts business with the United States, it must be "imposed equally on the other similarly situated constituents of the State." *United States* v. *County of Fresno,* 429 U.S. at 462. As the Court declared in *Fresno,* "[t]his rule returns to the original intent of M'Culloch v. Maryland." *Id.* at 462-63.

B. The Codification and Extension of Federal Tax Immunity In 31 U.S.C. §742.

In 1862, Congress passed a statute that specifically protected obligations of the United States from taxation by the states. Act of Feb. 25, 1862, ch. 33, §2, 12 Stat. 346. Today, that statute provides:

> "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes." 31 U.S.C. §742.

Early judicial interpretations of the first sentence of section 742 concluded that Congress' purpose simply was to codify the constitutional prohibition, recognized in *M'Culloch* and *Weston* v. *Charleston,* 2 Pet. 449 (1829), against state taxation of federal obligations. *See People ex rel. Bank of New York* v. *Hoffman,* 7 Wall. 16 (1869); *People ex rel. Bank of Commerce* v. *Commissioners,* 2 Black 620 (1863).

When the Court began, in *James* v. *Dravo Contracting Co.,* 302 U.S. 134 (1937), to curtail the protection afforded private taxpayers by federal tax immunity, however, there arose the question whether section 742 would be similarly reduced in scope. In *Society For Savings* v. *Bowers,* 349 U.S. 143 (1955), the Court unanimously held that section 742 exempted from state taxation federal obligations held by private banks, as well as the interest income derived from those obligations. Writing for the Court, Justice Harlan traced the ancestry of section 742 back to *Weston,* in which the Court had declared it unconstitutional for a municipality to apply its ad valorem property tax to United States bonds owned by an individual. The rule of *Weston,* opined Justice Harlan,

> "[w]as subsequently embodied in a succession of federal statutes, the existing statute being RS §3701, 31 USC §742. The rule has been carried forward to embrace indirect taxation of such obligations through their inclusion in a tax imposed on all the property of a taxpayer. It is quite immaterial that the state tax does not discriminate against the federal obligations." 2 Pet. at 144 (footnote omitted).

The second sentence of section 742, added in 1959, reinforces the Court's conclusion in *Society For Savings* that the statute protects both the United States and its private investors from state taxation. As the Senate Report on the 1959 amendment stated, the purpose of the bill was to "make[] it clear that the exemption for Federal obligations extends to *every form of taxation* that would require either the obligation, or the interest on it, or both to be considered *either directly or indirectly* in the computations of the tax . . . ." S. Rep. No. 909, 86th Cong., 1st Sess. (1959) (emphasis added), *reprinted in* 1959 U.S. Code Cong. & Ad. News 2769, 2773.

Thus, under section 742, a state tax on the income from United States credit instruments is invalid whether the tax is imposed directly on the United States or indirectly on one of its investors. The only exception recognized by the statute is for "*nondiscriminatory* franchise or other nonproperty taxes in lieu thereof imposed on corporations and . . . estate taxes or inheritance taxes." 31 U.S.C. §742 (emphasis added). As the words of the statute indicate, however, for a franchise tax on income derived from federal obligations to pass legal muster, the tax must not discriminate against the taxpayer on the basis of his or her decision to hold United States credit instruments instead of state and local obligations or other investments. *See* part A *supra*.

C. The Tennessee Bank Excise Tax Discriminates Against the Federal Government and Therefore Is Invalid.

Tennessee charges each bank in its jurisdiction an excise tax of three percent of the bank's net earnings, less ten percent of the ad valorem property taxes paid by the bank during the preceding fiscal year. Tenn. Code Ann. §67-751(1976). "Net earnings" is defined as federal taxable income, subject to certain adjustments that are not relevant here. *Id.* §67-2704. Federal taxable income generally includes income from United States securities. I.R.C. §61; 31 U.S.C. §742a; Treas. Regs. §1.103-4(b)(1). In recognition of principles of intergovernmental immunity, however, Congress has excluded from gross income the interest earned on state and local obligations. I.R.C. §103; *see Pollock* v. *Farmers Loan & Trust Co.*, 157 U.S. 429 (1895). Thus, by adopting federal taxable income as its definition of net earnings, Tennessee effectively imposes a tax on the income derived from United States obligations that is not applied to income from state and local obligations.[3]

The Tennessee Supreme Court below construed the Tennessee bank excise tax as a franchise tax. *Memphis Bank &*

[3] Tennessee also discriminates against obligations issued by other states and their local subdivisions by including income derived from those sources in the calculation of the bank excise tax. It requires that for the purpose of computing net earnings, federal taxable income be increased by the interest income earned on the credit instruments of other states and localities. Tenn. Code Ann. §67-2704(a)(2)(1976).

Trust Co. v. *Garner*, 624 S.W. 2d 551, 552-54 (Tenn. 1981), *prob. juris. noted*, 50 U.S.L.W. 3858 (U.S. Apr. 26, 1982). In so doing, the court attempted to bring the Tennessee statute within the franchise tax exception of section 742 and to invoke the general rule that a state may impose a tax on a corporation for the privilege of doing business in the state, even if the tax is measured in part by the value of tax-exempt federal securities or by the income on such securities, so long as the tax is nondiscriminatory. *Id.* at 554 (citing *Werner Machine Co.* v. *Director of Division of Taxation*, 350 U.S. 492 (1956); *Tradesmens National Bank of Oklahoma City* v. *Oklahoma Tax Commission*, 309 U.S. 560 (1940); *Pacific Co.* v. *Johnson*, 285 U.S. 480 (1932); *Educational Films Corp. of America* v. *Ward*, 282 U.S. 379 (1931); *Flint* v. *Stone Tracy Co.*, 220 U.S. 107 (1911)). Turning to the requirement that any franchise tax that includes the income from federal obligations must be nondiscriminatory, the Tennessee court simply dismissed the discrimination issue with the assertion that the Tennessee tax "does not single out federal obligations or the interest therefrom or in any other way treat them as special or direct objects of taxation . . . ." 624 S.W. 2d at 554. The court did not support its assertion, however, with any analysis.[4]

The Tennessee Supreme Court's construction of the bank excise tax as a nondiscriminatory tax on the privilege of doing business in Tennessee does not heal the statute's constitutional infirmity. A state's characterization of its tax is not binding on this Court where a federal right is at issue. *Society For Savings*

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[4] Indeed, each of the cases on which the Tennessee Supreme Court relied to support its characterization of the tax as a franchise tax involved taxes that were evenly applied to state and federal obligations or the income derived therefrom. *See Werner Machine Co.* v. *Director of Division of Taxation*, 350 U.S. at 492, 493-94 (1956) (franchise tax on corporate assets nondiscriminatory because "the tax remains the same whatever the character of the corporate assets may be"); *Tradesmens National Bank of Oklahoma City* v. *Oklahoma Tax Commission*, 309 U.S. 560, 566 (1940) (franchise tax measured by entire net income of taxpayer "without respect to source" sustained); *Pacific Co.* v. *Johnson*, 285 U.S. 480, 488 (1932) (franchise tax measured by net income of corporation including " 'all interest received from federal, state, municipal or other bonds' " upheld); *Educational Films Corp. of America* v. *Ward*, 282 U.S. 379, 385 (1931) (franchise tax measured by net income, including " 'dividends on stocks or any interest received on bonds of any character' " sustained); *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 143-44 (1911) (federal tax on every insurance company organized under laws of United States, states or territories, and foreign laws upheld).

v. *Bowers,* 349 U.S. 143, 151 (1955); *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals,* 338 U.S. 665, 674 (1950). In this case, the Court might well accept the Tennessee Supreme Court's construction of the bank excise tax as a franchise tax, while rejecting the state court's conclusionary statement that the tax is nondiscriminatory. For the Tennessee bank excise tax is precisely the type of tax that the Court consistently has condemned in the cases discussed in part A above.

Assuming arguendo that the Tennessee Supreme Court was correct in characterizing the Tennessee bank excise tax as a franchise tax, the state's taxation of bank income derived from federal obligations, in the absence of equivalent taxation of income from state and local bonds, violates both the statutory prohibition of discrimination contained in 31 U.S.C. §742 and the constitutional antidiscrimination principle of *M'Culloch* and its progeny. *See* part A *supra.* By taxing Tennessee banks on income derived from their investments in United States credit instruments, but not on income from Tennessee state and local bonds, the state effectively "imposes a lesser burden" on banks to the extent that they choose to deal with Tennessee or its political subdivisions instead of with the United States. *See Phillips Chemical Co.* v. *Dumas Independent School District,* 361 U.S. 376, 379 (1960).

In a case decided almost a century ago, the Court enunciated a simple test for determining whether a franchise tax is constitutionally nondiscriminatory. At issue in *Home Insurance Co. of New York* v. *People,* 134 U.S. 594 (1889), was a franchise tax imposed by the State of New York. The tax was measured, in part, by the amount of interest income from federal securities. The Court upheld the tax as a nondiscriminatory franchise tax for the following reason:

> "The tax in the present case would not be affected if the nature of the property in which the whole capital stock is invested were changed and put into real property *or bonds of New York,* or of other States." *Id.* at 601 (emphasis added); *see also* note 4 *supra* and cases cited therein.

The Tennessee tax fails this test. As described above, Tennessee excludes from the measurement of the tax any interest from bonds issued by the state or its local governments. Any

bank that is subject to the tax, which holds interest-bearing United States government securities, therefore, may reduce its tax burden simply by changing the character of that investment to bonds issued by Tennessee or its municipalities.

Schuylkill Trust Co. v. *Pennsylvania,* 296 U.S. 113 (1935), also is instructive. The question there was the constitutionality of a statute that the Commonwealth of Pennsylvania denominated as a tax on corporate shares, but which was attacked by the taxpayer as a tax on corporate assets. Pennsylvania measured the tax by calculating the portion of the value of corporate stock attributable to assets that had not been taxed or exempted from taxation under the laws of Pennsylvania. The Court found it unnecessary to determine whether the tax was a direct tax on federal securities or a tax in the nature of a franchise tax, because it held the statute to be discriminatory:

> "If the tax is lifted from the shares of certain trust companies because those companies own only stocks already taxed [by the State] or relieved from taxation by the State, and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities which are figured in the base of the tax, it is impossible to avoid the conclusion that the law discriminates in favor of the former and against the latter solely by reason of ownership of such federal securities." *Id.* at 120.[5]

As in *Schuylkill Trust,* the effect of the Tennessee bank excise tax is to encourage the holders of federal securities to shift their investments to securities that have been exempted from taxation by the state. Accordingly, the tax is unconstitutional.

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[5] The dispute again reached the Supreme Court in *Schuylkill Trust Co.* v. *Pennsylvania,* 302 U.S. 506 (1937). After the tax was held to discriminate against federal securities, the state taxing authority recalculated the tax to cure the defect. Upholding this recalculation the Court stated: "And the discrimination found upon the earlier appeal in failing to accord proportionate exemption to federal securities similar to that extended to exempt shares of domestic corporations has been removed, for all are now accorded like treatment by way of deduction." *Id.* at 514.

In essence, by adopting as its own the federal definition of gross income, Tennessee has turned on its head the doctrine of intergovernmental tax immunity that Congress has embodied in section 103 of the Internal Revenue Code. The United States has chosen to exempt from federal taxation the income derived from state and local bonds in recognition of the constitutional principle of intergovernmental immunity that this Court established in the nineteenth century. *See Commissioner* v. *Shamberg's Estate*, 144 F.2d 998, 1003 (2d Cir. 1944) (A. Hand, J.) (purposes of §103 were "to avoid raising 'any constitutional questions' " and "to avoid arousing 'the antagonism of the states' "), *cert. denied*, 323 U.S. 792 (1945); *cf. Weston* v. *Charleston*, 2 Pet. 449 (1829) (states may not tax income from federal bonds); *Pollock* v. *Farmers Loan & Trust Co.*, 157 U.S. 429 (1895) (United States cannot tax income from state and local bonds). Simply stated, that principle holds that the state and federal governments may not tax one another. When a state uses the federal definition of gross income for the purpose of calculating state tax liability, the state encroaches on the federal government's exclusive prerogative to tax income on United States obligations. Under the Tennessee scheme, for example, state bonds become more attractive investments relative to United States obligations, because income from the former are free from both federal taxation and the Tennessee bank excise tax while income from the latter are taxed by both sovereigns. This arrangement plainly violates the constitutional principles discussed in part A above, as well as 31 U.S.C. §742. As this Court stated over thirty years ago, section 742 was intended " 'to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit . . . .' " *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals*, 338 U.S. 665, 675 (1950) (quoting *Smith* v. *Davis*, 323 U.S. 111, 117 (1944)).

The State of Tennessee, through its bank excise tax, has attempted to enhance the value of its own state and local bonds to the detriment of United States Treasury instruments. The tax discriminates against the United States in a manner that has long been condemned by this Court. Unconstitutional in its application to bank income derived from federal investments, the Tennessee bank excise tax accordingly must fall.

D. The Question Presented in This Case Is of Broad National Concern Because Eighteen Other States Have Tax Schemes That Potentially Discriminate Against the United States and Thereby Impair Its Ability To Fund the Public Debt.

Analysis of other states' tax codes reveals that the problem of discriminatory tax treatment of federal obligations is by no means confined to Tennessee. As stated at the outset, section 17137.5 of the California Revenue and Taxation Code penalizes amici curiae for their decision to invest in federal, rather than California state or local, credit instruments. *See* pp. 2-3 *supra*. In addition, three other states—Pennsylvania, Alaska, and Ohio—expressly authorize their taxing agencies to discriminate against United States obligations. Like Tennessee, these states, in determining their franchise or corporate income taxes, follow the definition of gross income set forth in the Internal Revenue Code, which necessarily discriminates against the United States by taxing income from federal obligations while excluding income from state and local credit instruments.[6] *See* p. 11 *supra*.

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[6] Pennsylvania's corporate excise tax, titled the Corporate Net Income Tax, uses the Internal Revenue Code §61 definition of taxable income as its base. Pa. Cons. Stat. Ann. T.72, §7401(3) (Purdon 1981). The Supreme Court of Pennsylvania has declared this scheme unconstitutional. *Commonwealth* v. *Curtis Pub. Co.*, 363 Pa. 299, 69 A.2d 410 (1949), *cert. denied*, 339 U.S. 928 (1950). It is possible, however, that the state court might overrule *Curtis* in light of a decision in the instant case in favor of Appellees.

Alaska also bases its corporate income tax on the federal definition of taxable income. Alaska Stat. §43.20.031 (1981). This definition would appear to permit taxation of federal but not state bonds, because the Internal Revenue Code excludes state but not federal obligations from taxable income. I.R.C. §§61, 103; Treas. Regs. §1.103-4(b)(1); *see* 31 U.S.C. §742a.

Ohio imposes a franchise tax on its corporations by two different methods; each corporation must employ the method that yields the largest tax. Ohio Rev. Code Ann. §5733.06 (Page 1981). The first bases the tax on the corporation's federal taxable income before operating loss and special deductions, thereby apparently taxing federal but not state bonds. *Id.* §§5733.06(A)(B); 5733.05(B); 5733.04(I). The second bases the tax on the total value of the corporation's capital, surplus, undivided profits, and reserves, and does not appear to discriminate between federal and state obligations. *Id.* §§5733.06(C); 5733.05(A).

Six other states—Idaho, Indiana, Kentucky, Maine, New Mexico, and Vermont—base their corporate income and franchise taxes on the Internal Revenue Code definition of taxable income,[7] but qualify this by providing that no income may be taxed that is exempt from state taxation under federal law.[8] A seventh state, Louisiana, explicitly exempts its own bonds from taxation without providing similar treatment for federal obligations[9] and then adds the caveat that no income may be taxed that is exempt by law from state taxation.[10] Seven additional states—Georgia, Kansas, Minnesota, Missouri, Nebraska, Virginia, and West Virginia—exempt federal bonds from state taxation only to the extent required by United States law.[11]

These statutes may acknowledge the doctrine of federal supremacy as a theoretical matter, but practical application of the principle is by no means assured. For example, California in section 17137 of its Revenue and Taxation Code provides that gross income does not include income that is exempt from taxation under the Constitution or laws of the United States. Nevertheless, section 17137.5 is applied in a manner that discriminates against those, like amici curiae, who have chosen to invest in federal obligations rather than state or local bonds. *See* pp. 2-3 *supra.*

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[7] Idaho Code §63-3022 (1981); Ind. Code Ann. §6-3-1-3.5(b) (West 1982); Ky. Rev. Stat. Ann. § 141.010(12)(13) (Bobbs-Merrill 1982); Me. Rev. Stat. Ann. tit. 36, §5102.8 (1981); N.M. Stat. Ann. §7-2A-2.M (1981); Vt. Stat. Ann. tit. 32, §5811(18) (1981).

[8] Idaho Code §63-3022(g) (1981); Ind. Code Ann. §6-3-1-3.5(b)(1) (West 1982); Ky. Rev. Stat. Ann. §141.010(12)(a) (Bobbs-Merrill 1982); Me. Rev. Stat. Ann. tit. 36, §5102.8.A (1981); N.M. Stat. Ann. §7-2A-2.N(2) (1981); Vt. Stat. Ann. tit. 32, §5811(18) (1981).

[9] La. Rev. Stat. Ann. 47:48 (West 1981).

[10] The Louisiana statutes do not refer expressly to tax-exempt income. Rather, La. Rev. Stat. Ann. §47:54.A (West 1981) merely provides that no deduction shall be allowed for interest accrued or paid "on indebtedness incurred or construed to purchase or carry the obligations, or securities the income from which is wholly exempt by law from the taxes imposed by this Chapter."

[11] Ga. Code §91A-3602(b)(1)(B) (1980); Kan. Stat. Ann. §79-32, 117(c)(i) (1981); Minn. Stat. Ann. §290.01-20(b)(1) (West 1981); Mo. Ann. Stat. §143.121.3(a) (Vernon 1981); Neb. Rev. Stat. §77-2716 (1981); Va. Code §58-151.013(c)(1) (1981); W. Va. Code §11-24-6(c)(2) (1980).

In sum, eighteen states in addition to Tennessee potentially discriminate against federal obligations in favor of their own bonds and securities. The ramifications of the Court's decision in this case therefore are far-reaching. If the Court were to affirm the decision of the Tennessee Supreme Court below, federal obligations could be seriously disadvantaged in the marketplace for government securities in nineteen of the fifty states. Whether other states subsequently would decide to enact similarly discriminatory laws is an open question, but it is unlikely that, as competitors of the United States for debt financing, they would eschew a competitive edge if it reasonably were open to them. Under such circumstances, the ability of the United States to compete effectively for investors, and thereby to finance the public debt, would be substantially impaired.

CONCLUSION

Presented with the question whether a state may tax the interest income derived from United States Treasury instruments, while exempting from taxation the interest earned on its own state and local obligations, the Court should answer with a resounding no. The Tennessee bank excise tax at issue on this appeal discriminates against the Memphis Bank and Trust Company for having chosen to invest its funds with the United States instead of in Tennessee state or local bonds. This kind of discrimination is inconsistent with federal statutory law and violates the venerable constitutional principle that a state may not impose a tax on those who deal with the United States unless an equivalent tax is levied on similarly situated constituents of the state. The constitutional prohibition against such discrimination, which dates back to *M'Culloch* v. *Maryland,* has served this nation well by ensuring that the United States can compete on an equal footing with other governmental entities in securing public financing of its debt. Because a large number of states along with Tennessee have enacted tax schemes that seem to favor their credit obligations over those of the United States, a departure from the principle of

nondiscrimination could have serious adverse effects on the ability of the United States to market its obligations and thus to raise the funds necessary to finance the public debt. For these reasons, the Court should hold that the Tennessee bank excise tax unconstitutionally discriminates against the United States and should reverse the judgment of the Tennessee Supreme Court.

DATED: July 8, 1982.

Respectfully submitted,

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Amicus Brief

2

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No. 81-1613

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October Term, 1981

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and

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Appellees.

ON APPEAL FROM THE SUPREME COURT OF TENNESSEE

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To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The Farm Credit Banks respectfully move, pursuant to Rule 36 of the Rules of this Court, for leave to file the attached brief as *amici curiae* in support of Appellant's position that the Tennessee Bank Tax, as measured by a bank's "net earnings," including earnings from Treasury securities and Farm Credit Securities, violates the

Supremacy Clause of the United States Constitution and 12 U.S.C. §§ 2055, 2079, and 2134 and 31 U.S.C. § 742.

The consent of all parties has been requested, and the consent of the Appellant has been obtained. The consents of Appellees Riley C. Garner, Shelby County Trustee, and the State of Tennessee were refused. The consent and the refusals are filed herewith. In the event that an additional consent or refusal is received, it will be promptly filed.

The 37 Farm Credit Banks (i.e., the 12 Federal Land Banks, the 12 Federal Intermediate Credit Banks, and the 13 Banks for Cooperatives) are Federal instrumentalities which carry out the Congressionally mandated role of providing a reliable source of credit for agriculture.[1] The interest of the Farm Credit Banks arises from the fact that most of the "net earnings" at issue in this case consists of interest earned by Memphis Bank & Trust Company on bonds and debentures issued by the Farm Credit Banks (i.e., Farm Credit Securities).[2] The Farm Credit Banks'

[1]For brief descriptions of the Farm Credit System, see H.R. Rep. No. 96-1287, 96th Cong., 2d Sess., *reprinted in* [1980] U.S. Code Cong. and Admin. News 7095, 7098-7100; S. Rep. No. 96-837, 96th Cong., 2d Sess. 4-7 (1980); and *United States v. Mississippi Chemical Corp.*, 405 U.S. 298, 301-305 (1972).

[2]Specifically, Appellant's "net earnings" for the year 1976 (the base year for the 1977 intangible personal property tax) included $1,145,203 of interest on U.S. Treasury Notes and Bills, $1,793,999 of interest earned on Federal Land Bank and Federal Intermediate Credit Bank obligations, and $236,914 of interest earned on obligations of other U.S. agencies or instrumentalities. *See* Joint Appendix pp. 36a-37a.

Appellant's "net earnings" for the year 1977 (the base year for the 1978 intangible personal property tax) included $848,798 of interest on U.S. Treasury Notes and Bills, $2,547,153 of interest earned on Federal Land Bank, Federal Intermediate Credit Bank, and Banks for Cooperatives obligations, and $179,716 of interest earned on obligations of other U.S. agencies or instrumentalities. *See* Joint Appendix pp. 37a-38a.

concern is with the effect that the decision below, if allowed to stand, will have on the interest that the Farm Credit Banks would have to pay on their notes and bonds, which will affect the interest rate that must be charged on loans made to farmers and others by the Farm Credit Banks. Several other states have already attempted to circunvent the federal tax exemption statutes by imposing taxes similar to the Tennessee Bank Tax (*see* Jurisdictional Statement at 13), and more states can be expected to do likewise if the Tennessee tax is upheld.

Congress created the Farm Credit Banks in order to make credit available for agricultural purposes at the lowest reasonable interest rate. *See* 12 U.S.C. §§ 2015, 2075, and 2096(b). The Farm Credit Banks obtain their funds in the capital markets by issuing notes and bonds. Commercial banks are among the principal purchasers of Farm Credit Securities. *See Treasury Bulletin*, April 1982, Table TSO-5, p. 67.

As early as 1916, Congress provided that interest earned on notes and bonds issued by the Farm Credit Banks would be exempt from all state and local taxation. Such exemption was deemed essential to the Farm Credit Banks' ability to market their obligations and obtain funds at the lowest possible rate, and in turn, to fulfill their Congressionally mandated purpose of making credit available for agricultural purposes at the lowest reasonable rate. That Congress clearly understood this relationship when it established the Federal Land Banks is evident by the following statement from the Report of the United States Commission on Agricultural Credit, which was before the Congress when it first legislated on this issue: "[I]n order that the farmer shall get the benefit of the lowest interest rate, these land-bank bonds . . . must be exempted from taxation. . . . [A] tax upon the land-bank bond issued by the bank . . . must ultimately be paid by the farmer in the

shape of increased interest charges . . . . It will be impossible to secure money for the farmer on the best terms, unless and until such an exemption goes into effect." S. Doc. No. 380, 63rd Cong., 2d Sess. 33 (1914); *accord,* 53 Cong. Rec. 7317, 7375, 7391, 7537, 7704, 7718, 7724, 7820 (1916).

If interest on Farm Credit Securities is included in a bank's "net earnings" for the purpose of measuring state taxes such as the Tennessee Bank Tax, then these securities will be less marketable and the Farm Credit Banks will have to pay a higher rate of interest to obtain funds. This would seriously impair the Farm Credit Banks' ability to carry out their obligation, especially important today in light of the economic crisis currently faced by America's farmers, to make credit available to the nation's farmers at the lowest reasonable interest rate. Thus, the Farm Credit Banks' ultimate interest in this case lies not in the amount of taxes paid by Appellant, but in the effect such taxes will have on the ability of the Farm Credit Banks to obtain funds for agricultural loans and on the interest rates that the Farm Credit Banks must charge to farmers on such loans.

In the decision below the Supreme Court of Tennessee focused its analysis entirely on 31 U.S.C. section 742, which exempts the interest on Treasury Notes and Bonds from state and local taxation. The Supreme Court of Tennessee made only a passing reference to 12 U.S.C. sections 2055, 2079, and 2134, which exempt the interest on Farm Credit Securities from all state and local taxation. Similarly, the Jurisdictional Statement, the Motions to Dismiss or Affirm, and the Reply Brief related thereto already filed with this Court focus their analysis on Treasury obligations and only briefly mention Farm Credit Securities. It is believed that the brief which the *amici curiae* are requesting permission to file will contain a more thorough

analysis and complete argument with respect to the tax exemptions for interest on Farm Credit Securities.

WHEREFORE, it is respectfully requested that the Court grant the Farm Credit Banks leave to file the attached brief as *amici curiae* in support of Appellant.

Respectfully submitted,

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ON APPEAL FROM THE SUPREME COURT OF TENNESSEE

BRIEF OF THE FARM CREDIT BANKS AS AMICI CURIAE IN SUPPORT OF APPELLANT

The Farm Credit Banks respectfully submit this brief as *amici curiae* to urge the Court to reverse a decision of the Supreme Court of Tennessee, holding that a state tax on banks can be measured by interest earned on, *inter alia,* Federal Land Bank bonds, Federal Intermediate Credit Bank debentures, and Bank for Cooperatives bonds, notwithstanding that three federal statutes explicitly exempt

the interest earned on those bonds and debentures from all state and local taxation.

As shown in the foregoing motion, because commercial banks purchase a significant percentage of all Farm Credit Securities[1] that are issued, the result reached below could very seriously impair the ability of the Farm Credit System to accomplish its Congressionally mandated goal of making credit available for agricultural purposes "at the lowest reasonable costs." *See* 12 U.S.C. §§ 2015, 2075, 2096(b).

SUMMARY OF ARGUMENT

The three separate statutes that exempt Farm Credit Securities from state taxation all grant identical exemptions to those securities. Moreover, the tax exemption for Farm Credit Securities is identical in scope to the exemption for Treasury securities. The exemption of Treasury and Farm Credit obligations clearly extends to the consideration of such obligations or the interest thereon in the computation of a state tax, other than a nondiscriminatory franchise tax (or a nonproperty tax in lieu thereof).

The Tennessee Bank Tax imposed by Section 67-751 of the Tennessee Code Annotated is unconstitutional for two separate and independent reasons. First, the Tennessee Bank Tax is an intangible personal property tax on U.S. and Farm Credit obligations; it is neither a franchise tax nor a nonproperty tax in lieu thereof. Therefore, the Tennessee Bank Tax violates 12 U.S.C. sections 2055, 2079, and 2134, and the Supremacy Clause of the Constitution (Art. VI, cl. 2), regardless of whether the tax is

[1] "Farm Credit Securities," as used herein, refers to Federal Land Bank bonds, Federal Intermediate Credit Bank debentures, and Bank for Cooperatives bonds, as well as Systemwide Farm Credit Bonds and Notes issued pursuant to 12 U.S.C. § 2153(d) (see pp. 6-7, *infra*).

discriminatory. Second, the Tennessee Bank Tax discriminates against U.S. and Farm Credit obligations in favor of obligations of the State of Tennessee. Therefore, the Tennessee Bank Tax violates 12 U.S.C. sections 2055, 2079, and 2134, and the Supremacy Clause of the Constitution (Art. VI, cl. 2), regardless of the nature of the tax (i.e., even if it is deemed to be a franchise tax or a non-property tax in lieu thereof).

ARGUMENT

I.

THE THREE TAX EXEMPTION STATUTES FOR FARM CREDIT SECURITIES ALL GRANT IDENTICAL EXEMPTIONS FROM TAXATION OF INTEREST ON SUCH SECURITIES

There are three different Farm Credit Securities involved here – Federal Land Bank bonds, Federal Intermediate Credit Bank debentures, and Bank for Cooperative bonds. Since Congress created the three types of Farm Credit Banks at different times, three separate statutes provide the tax exemptions for interest earned on their obligations. Although there are minor differences in the current operative statutory language,[2] these differences are, for purposes of this case, without substantive effect. The legislative history of these provisions shows that all three tax exemption statutes provide a complete and total exemption from state and local taxation of both the Farm Credit Securities themselves and the interest earned thereon.

[2]Federal Land Bank bonds and Federal Intermediate Credit Bank debentures "and the income therefrom" are exempt from all state and local taxation (12 U.S.C. §§ 2055, 2079) while Banks for Cooperatives' obligations are exempt "both as to principal and interest" from all state and local taxation (12 U.S.C. § 2134).

Congress enacted the Federal Farm Loan Act of 1916 (39 Stat. 360) in order to provide credit to farmers at the lowest possible interest rate. *Federal Land Bank v. Kiowa County,* 368 U.S. 146, 151 (1961); *Federal Land Bank v. Bismarck Lumber Co.,* 314 U.S. 95, 100 (1941). The 1916 Act created Federal Land Banks to provide long-term loans to farmers secured by first mortgages. Congress provided the initial capital for the Federal Land Banks but expected them eventually to become privately financed by selling farm loan bonds. *See* S. Rep. No. 144, 64th Cong., 1st Sess. 4 (1916). To facilitate the sale of these bonds, Section 26 of the 1916 Act specifically provided that farm loan bonds "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." § 26 of Federal Farm Loan Act of 1916, 39 Stat. 380.

While Congress has not disturbed the basic Federal Land Bank system, it has supplemented it at various times. The Agricultural Credits Act of 1923 (42 Stat. 1454) created the Federal Intermediate Credit Banks to provide short and intermediate term credit for agricultural operations. The Farm Credit Act of 1933 created the Banks for Cooperatives for the purpose of making loans to agricultural cooperatives. As it did in the case of the Federal Land Banks, Congress provided the initial capital for the Federal Intermediate Credit Banks and the Banks for Cooperatives, but expected them to become privately financed by issuing their own obligations. To facilitate the sale of these obligations at the lowest possible interest rate, Congress granted them complete tax exemptions. *See* H.R. Rep. No. 1712, 67th Cong., 4th Sess. 17-18 (1923); H.R. Rep. No. 171, 73rd Cong., 1st Sess. (1933); S. Rep. No. 124, 73rd Cong., 1st Sess. (1933); 64 Cong. Rec. 4930 (1923).

Specifically, the Agricultural Credits Act of 1923 added § 210 to the Federal Farm Loan Act to provide that

> "the privileges of tax exemption accorded under section 26 of this Act [i.e., the exemption for Federal Land Banks and Federal Land Bank bonds] shall apply also to each Federal Intermediate Credit Bank, . . . and the debentures issued under this title shall be deemed and held to be instrumentalities of the Government and shall enjoy the same tax exemptions as are accorded farm loan bonds in said section." § 210 of the Federal Farm Loan Act, as added by the Agricultural Credits Act of 1923, 42 Stat. 1454, 1459.

Section 63 of the Farm Credit Act of 1933 provided that obligations of the Banks for Cooperatives

> "shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority." § 63 of the Farm Credit Act of 1933, 48 Stat. 257, 267.[3]

These three original statutes providing the tax exemptions for both the principal of, and interest on, the obligations of Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives[4] remained in effect,

[3]Section 63 also provided that the Banks for Cooperatives would lose their own exemption from taxation when the U.S. Government capital was repaid, but the exemption of the Banks for Cooperatives themselves has no effect on the tax exemption for interest on their obligations.

[4]The original tax exemption provisions for Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives were codified at 12 U.S.C. §§ 931, 1111, and 1138c (1970 ed.), respectively, until repealed in 1971.

with only minor amendments not relevant here,[5] until they were replaced with new provisions in 1971. The Farm Credit Act of 1971 (85 Stat. 583, codified at 12 U.S.C. § 2001, *et. seq.*) was enacted "to modernize and consolidate existing farm credit law," (H.R. Rep. No. 92-593, 92d Cong., 1st Sess., *reprinted in* [1971] U.S. Code Cong. & Admin. News 2091, 2091), and while the specific language of the new tax exemption provisions differs in some respects from the old provisions, it is clear that no substantive changes were made. The exemptions for Federal Land Bank and Bank for Cooperative bonds were simply "reenacted" in Sections 2055 and 2134 of Title 12, respectively.[6] *Id.* pp. 2107, 2113. The new exemption for Federal Intermediate Credit Bank obligations in Section 2079 of Title 12 is "identical in substance" with the preexisting exemption. *Id.* p. 2109. The current tax exemption provisions, which have not been amended since 1971, are set out in full in the Appendix to the Brief of Appellant, pp. 1a-2a. Accordingly, so far as is relevant here, there have been no substantive changes in the tax exemption provisions for Farm Credit Securities since they were originally enacted.

With respect to taxation of interest earned on Federal Land Bank, Federal Intermediate Credit Bank, or Bank for Cooperative obligations (as opposed to taxation of the banks themselves), the Farm Credit Act of 1971 clearly demonstrates that the three tax exemptions must all have

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[5]The Public Debt Act of 1941, 55 Stat. 9, codified at 31 U.S.C. § 742a, eliminated the exemption from Federal income taxes for interest on both Farm Credit Securities and Treasury securities (except as provided in the Internal Revenue Code).

[6]Technical corrections were made in 1971, such as adding the exception regarding Federal income tax liability under the Public Debt Act of 1941.

identical meaning. The 1971 Act authorized all three types of Farm Credit Banks "to join in the issuance of a single, systemwide obligation to obtain loan funds from the wholesale markets." H.R. Rep. No. 92-593, 92d Cong., 1st Sess., *reprinted in* [1971] U.S. Code Cong. & Admin. News 2091, 2101; *see* 12 U.S.C. § 2153(d). Each of the three tax exemption provisions must apply to each systemwide obligation because each exemption provision applies to all obligations "issued by" the relevant type of Farm Credit Bank, and systemwide obligations are "issued by" all three types of Farm Credit Banks. It is obvious that in practical effect a single, systemwide obligation can only have one single tax exemption. Thus, the three tax exemption provisions must have an identical meaning because all three statutes now apply to interest on the same notes and bonds.[7]

THE TAX EXEMPTION FOR FARM CREDIT SECURITIES IS IDENTICAL TO THAT PROVIDED BY 31 U.S.C. § 742 FOR TREASURY OBLIGATIONS

The language of the statute that exempts Treasury obligations from state and local taxation (31 U.S.C. § 742) differs in some respects from the language of the statutes that exempt Farm Credit Securities from state and local taxation (12 U.S.C. §§ 2055, 2079, and 2134). The statute exempting Treasury obligations specifically states that interest on Treasury obligations may not be taxed "directly or indirectly," while the statutes exempting Farm Credit

[7]The Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives no longer issue their own bonds or debentures. Instead, all three types of Farm Credit Banks join together and issue only systemwide bonds and notes, which are the obligations of all of the participating banks. *See* 12 C.F.R. Part 615, Subparts C and O, as amended, 47 Fed. Reg. 12136 (Mar. 22, 1982).

Securities do not include that language. On the other hand, the statute exempting Treasury obligations specifically permits "nondiscrimi[illegible]ory franchise or other nonproperty taxes in lieu thereof," while the statutes exempting Farm Credit Securities do not specifically state that such taxes are permitted.

However, these differences in statutory language are without substantive effect. They were added in 1959 to the statute exempting Treasury obligations as clarifications of then existing law. *See* Pub. L. No. 86-346, 73 Stat. 621 (1959). The 1959 amendment did not effect any substantive change in the scope of the tax exemption for Treasury securities, which has always been identical to the exemption for Farm Credit Securities.

A. Congress Intended Farm Credit Securities to have the Same Exemption from State and Local Taxation as Treasury Securities.

When it enacted the first statutory provision exempting Farm Credit Securities from taxation, Congress did not intend to grant less than full immunity. As the legislative history discussed below indicates, many members of Congress felt that the Constitution itself would exempt Farm Credit Securities from taxation, just as the Constitution itself exempts Treasury securities. Nevertheless, Congress enacted the statutory provision to make its intent clear, and the legislative history of that enactment demonstrates that Congress intended the exemption for Farm Credit Securities to be co-extensive with the exemption for Treasury securities.

The doctrine of constitutional immunity of federal instrumentalities from state taxation was well established when Congress created the Federal Land Banks. That doc-

trine protected obligations of federally created banks as well as obligations of the Federal Government itself. *See McCulloch v. Maryland,* 17 U.S. (4 Wheat.) 316 (1819); *Osborn v. Bank of the United States,* 22 U.S. (9 Wheat.) 738 (1824); *Weston v. City Council of Charleston,* 27 U.S. (2 Pet.) 449 (1829); *Owensboro National Bank v. Owensboro,* 173 U.S. 664 (1899). Nevertheless, the tax exemption for farm loan bonds was thoroughly discussed by the Congress that created the Federal Land Banks. Many members of that Congress felt that whether the instrumentalities they were creating (both the banks and the bonds) were exempt from state and local taxation was a constitutional question and that those instrumentalities would be exempt from taxation even in the absence of a statute.[8]

The Congressional debates on the Federal Farm Loan Act of 1916 show that Congress granted an explicit statutory immunity because of the critical importance of the marketability of farm loan bonds at a low interest rate to the successful operation of the Farm Credit System. *See* 53 Cong. Rec. 7931 (1916) ("the absolute success of this whole rural-credit system rests upon the ready salability of the bonds at advantageous prices"); *accord, Id.* at 7317, 7375, 7391, 7820, 7821, 7830; H.R. Rep. No. 630, 64th Cong., 1st Sess. 7 (1916). Congress recognized that it was merely eliminating any doubt by expressly declaring the exemption:

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[8]The Congressional debates on the provision contain numerous statements to the effect that "[w]hen the United States . . . creates an instrumentality operating in a State exemption from taxation is a judicial question and can not be affected by legislative action," (53 Cong. Rec. 7245 (1916)) and that "if this property is exempt, it is exempt because of the principles laid down in McCulloch against Maryland, in Osborn against The Bank, and in the Owensboro Bank case." 53 Cong. Rec. 7377 (1916). Similar statements appear at 53 Cong. Rec. 6962-63, 6967, 6969, 7025, 7246, 7305, 7306, 7307, 7312, 7375, 7392 (1916).

> "[I]f there were any doubt about the matter the declaration upon the part of Congress to the effect that they would not be able to carry out their purposes except by this exemption, and that Congress intended they should be exempt, will serve to remove whatever doubt there may be concerning the exemption . . . ." 53 Cong. Rec. 7376 (1916).

The Congressional debates show that the exemption was plainly declared for the benefit of both investors and the courts:

> "[A]ssume that these are instrumentalities of the United States and would be exempt from taxation without the intervention of any statute or judicial decision, would we not be foolish not to declare our intention . . . so that investors would know from the act itself that they were exempt from taxation . . . .
>
> [W]e are continually declaring things that are in the Constitution just to put our moral strength and weight back of them; and it will have some effect on the Supreme Court of the Unted States even if it were not necessary that we should do it in this instance." 53 Cong. Rec. 7312 (1916).

Congress recognized that it had done precisely the same thing with respect to Treasury securities — i.e., enacted a statute that was believed to be unnecessary and merely declaratory of an exemption that arises out of the Constitution[9] — and looked to its earlier action with respect to

[9]Obligations of the Federal Government had been held immune from state taxation in *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829), and Congress subsequently embodied this rule in a succession of federal statutes beginning with the Act of February 25, 1862, c. 33, § 2, 12 Stat. 346 (the existing statute being R.S. § 3701, 31 U.S.C. § 742).

Treasury securities as a precedent for making the statutory declaration that farm loan bonds are immune from state and local taxation. *See* 53 Cong. Rec. 7312, 7375 (1916). Therefore, the statutory exemptions for both Farm Credit Securities and Treasury securities are cast in very general but complete and absolute terms because Congress generally felt that the scope of the exemption is constitutionally based, and is not dependent on the precise language of the statute.

That Congress intended the exemption for farm loan bonds to be as broad as the exemption for Treasury bonds is clear from the following statements from the Congressional debates:

> "It is to be borne in mind that the price of the bond determines the interest rate to the borrower [the farmer] . . . For [this] reason land bonds are freed from all forms of taxation – State, municipal, and National – including income taxes. *They are given every exemption in this regard which is granted to Government bonds.* We expect then [sic] to sell at approximately the price of Government bonds, and we are giving them all the attractive elements of such a security." 53 Cong. Rec. 7537 (1916) (emphasis added).

> "These bonds are made free from all forms of taxation – income, State, and local. . . . *These bonds will be as safe as our Government bonds. They are as free from taxation."* 53 Cong. Rec. 7714 (1916) (emphasis added).[10]

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[10]The debates reveal other comparisons with Treasury obligations, including: Farm loan bonds were intended to be "as attractive to the investors of this country as the security issued by any State or by the Government of the United States, and we confidently expect to get as low a rate of interest as is secured by the Government on its

B. The Decisions of This Court Treat the Tax Exemption for Farm Credit Securities as Identical to the Tax Exemption for Treasury Securities.

The decisions of this Court, interpreting and applying the tax exemptions, have consistently treated the immunity from state taxation enjoyed by Farm Credit Securities and Treasury securities as identical. Decisions under both exemptions have been decided on the basis of constitutional principles, generally with only a passing reference to the actual language of the statutes. This is consistent with, if not compelled by, the legislative history of the statutes and by the Constitution

The exemption of Farm Credit Securities from state and local taxation first came before this Court in *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180 (1921) (shareholder suit to enjoin a company from purchasing farm loan bonds). This Court upheld the constitutionality of the tax exemption for Farm Credit Securities, relying on the general constitutional doctrines established in the National Bank cases (*i.e., McCulloch v. Maryland,* 17 U.S. (4 Wheat.) 316 (1819); *Osborn v. Bank of the United States,* 22 U.S. (9 Wheat.) 738 (1924); *Owensboro National Bank v. Owensboro,* 173 U.S. 664 (1899)). With respect to state taxation of interest earned on Farm loan bonds, the Court

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securities," 53 Cong. Rec 7538 (1916); "Every safeguard is thrown around the bonds. They are as good as Government bonds and should find as ready a market," 53 Cong. Rec. 7704 (1916); Farm loan bonds "ought to be just as good as any United States Government Bonds," 53 Cong. Rec. (App.) 1350 (1916).

repeated the basic reasoning underlying the National Bank cases, saying:

> "The exercise of such taxing power by the states might be so used as to hamper and destroy the exercise of authority conferred by Congress, and this justifies the exemption. If the states can tax these bonds, they may destroy the means provided for obtaining the necessary funds for the future operation of the banks." 255 U.S. at 213.

In *Macallen Co. v. Massachusetts,* 279 U.S. 620 (1929), this Court addressed a state tax on corporations, which although measured by net income, had been held by the state courts to be a tax on the privilege of doing business (i.e., a franchise tax). This Court questioned whether the tax "under the guise of that designation, is in substance and reality a tax on the income derived from tax-exempt securities," (279 U.S. at 626) and held that it was. 279 U.S. at 634. The tax exempt securities included both United States bonds and farm loan bonds. Treating the two exemptions as identical, the Court analyzed the issue as to both types of bonds together, without in any way differentiating between the two types of bonds. After noting that farm loan bonds are instrumentalities of the United States, the Court said that

> "the controlling principle, constantly to be borne in mind, is that the states cannot tax the instrumentalities [*i.e.,* Federal Farm Loan bonds] or bonds of the United States, or, what is the same thing, the income derived therefrom, *directly or indirectly;* that is to say, it cannot tax *them* in any form." 279 U.S. at 629 (first emphasis added; second emphasis in original).

Thus, *Macallen* held that states can not impose an indirect

tax, disguised as a franchise tax, on either Treasury securities or farm loan bonds.[11]

Similarly, *Federal Land Bank v. Crosland*, 261 U.S. 374 (1923) held that Section 26 of the Federal Farm Loan Act prohibited indirect as well as direct taxes. *Crosland* dealt with a state's attempt to impose a tax on the privilege of recording or registering a Federal Land Bank mortgage (section 26 of the Federal Farm Loan of 1916 granted mortgages held by Federal Land Banks the same tax exemption as farm loan bonds). Although the Federal Land Bank was not required to record the mortgage, and could thereby avoid the tax, this Court held that because state law made it practically necessary to record the mortage deed, the tax on the privilege of recording amounted to an indirect tax on the mortgage itself, and was therefore prohibited:

> "The state is not bound to furnish a registry, but if it sees fit to do so *it cannot use its control as a means to impose a liability that it cannot impose directly* . . . ." 261 U.S. at 378 (emphasis added).

Since Federal Land Bank bonds and mortgages have the same tax exemption and since that exemption prohibits indirect taxes on the mortgages, it also prohibits indirect taxes on Federal Land Bank bonds.

In another context, that of a state tax on shares measured by the value of the company's net assets (*i.e.*, a bank share tax), this Court treated farm loan bonds as

[11]To the extent that *Macallen* held that a state statute was invalid because of the intent or purpose of the state legislature, its vitality has perhaps been eroded. *See Tradesmens Bank v. Tax Commission*, 309 U.S. 560, 566 (1940). But the propositions for which *Macallen* is cited here – its ruling that both direct and indirect taxes on Treasury and farm loan bonds are prohibited, and its treatment of the tax immunities of Treasury and farm loan bonds as identical – have not been questioned.

identical, for purposes of the tax exemption, to United States Government bonds. *Schuylkill Trust Co. v. Pennsylvania,* 296 U.S. 113 (1935) (*Schuylkill I*). *Schuylkill I* held that the tax was unconstitutional because it discriminated against both United States bonds and farm loan bonds.[12] The Court's opinion did not even refer to the exemption statutes, nor did the Court's opinion even specify that farm loan bonds were involved – it simply referred to Government bonds and bonds of Federal instrumentalities, and one must refer to the parties' briefs to determine that the instrumentalities at issue were farm loan bonds (*see* 80 L.Ed. 91, at pp. 92, 94). Similarly, after the discriminatory features were removed on remand, the tax was upheld; again, the Court saw no need to refer to the exemption statutes, and simply referred to bonds of the federal government and instrumentalities without specifying farm loan bonds. *See Schuylkill Trust Co. v. Pennsylvania,* 302 U.S. 506 (1938) (*Schuylkill II*) and 82 L.Ed. at 393 (brief for appellant identifies farm loan bonds).

Again, in *Tradesmens Bank v. Tax Commission,* 309 U.S. 560 (1940), where the issue was the validity of a tax on national banks measured by their net income, the Court gave identical treatment to interest from the following types of tax-exempt securities: "U.S. Treasury Notes;

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[12]The particular type of farm loan bonds involved in the *Schuylkill* cases were joint stock land bank bonds. The Federal Farm Loan Act of 1916 authorized joint stock land banks as well as Federal Land Banks to issue farm loan bonds, and the tax exemption provided by section 26 of that Act applied equally to farm loan bonds issued by either type of bank. *See* § 2 of the Federal Farm Loan Act of 1916 (formerly codified at 12 U.S.C. § 642, 1970 ed). The Farm Credit Act of 1933 provided for the elimination of the joint stock land banks, and the Farm Credit Act of 1971 eliminated the references to joint stock land banks in the tax exemption provision.

U.S. Treasury Bonds; Bonds of the Federal Farm Loan Act; Joint Stock Land Bank Bonds; Home Owners' Loan Corporation Bonds; and Federal Land Bank Bonds." 309 U.S. at 562 n. 2. The Court did not quote from or even refer to the several exemption statutes, and merely identified the specific securities at issue in a footnote.

C. The 1959 Amendment to 31 U.S.C. § 742 Merely Clarified That Statute by Adding Certain Particulars That Were Already Well Established in Decisions of this Court.

When Congress amended 31 U.S.C. section 742 in 1959 (Pub. L. No. 86-346, 73 Stat. 621), it merely added several particulars regarding the exemption of Treasury securities from state taxation that were already clearly and firmly established. It was clear that the prohibition of state taxation of Treasury securities extended to indirect as well as direct taxation. *See New Jersey Realty Title Insurance Co. v. Division of Tax Appeals,* 338 U.S. 665, 673 (1950); *Macallen Co. v. Massachusetts,* 279 U.S. 620, 629 (1929); *Miller v. Milwaukee,* 272 U.S. 713, 715 (1927); *Home Insurance Co. of New York v. New York,* 134 U.S. 594, 598 (1890). It was also well settled that a state could impose a nondiscriminatory franchise tax on corporations, even if that tax was measured by net income, including income from tax-immune Treasury securities. *Werner Machine Co., Inc. v. Director of Division of Taxation,* 350 U.S. 492, 494 (1956); *Tradesmens Bank v. Tax Commission,* 309 U.S. 560, 564-65 (1940); *Pacific Co. v. Johnson,* 285 U.S. 480, 489-90 (1932); *Educational Films Corp. v. Ward,* 282 U.S. 379, 392 (1931).

Nevertheless, by adding the second sentence to 31 U.S.C. section 742 in 1959, Congress specifically prohibited indirect as well as direct taxes and provided an ex-

ception for nondiscriminatory franchise taxes.[13] The legislative history of the 1959 amendment, although sparse, clearly shows that Congress was clarifying and restating existing law and not making any substantive change in the law. *See* S. Rep. No. 909, 86th Cong., 1st Sess., *reprinted in* [1959] U.S. Code Cong. and Admin. News 2769, at 2769, 2773-74, 2777; H.R. Rep. No. 1148, 86th Cong., 1st Sess. 2, 8, 12 (1959); *Hearings on Public Debt Ceiling and Interst Rate Ceiling on Bonds,* before the House Ways and Means Committee, 86th Cong., 1st Sess. 8, 69-72 (1959).

Therefore, although 31 U.S.C. section 742 permits nondiscriminatory franchise taxes on, or measured by, the value of Treasury securities or the income therefrom, while 12 U.S.C. sections 2055, 2079, and 2134 do not contain similar language, the difference is of no consequence because the 1959 Amendment (which added this exception to 31 U.S.C. section 742) did not narrow or broaden the immunity of Treasury securities from state taxation. Similarly, the fact that 31 U.S.C section 742 specifically prohibits indirect taxation, while 12 U.S.C. sections 2055, 2079, and 2134 do not, is of no consequence — States cannot tax either Treasury securities or Farm Credit Securities directly or indirectly.

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[13]It had also been clearly established that states could impose estate or inheritance taxes on Treasury obligations. *See Plummer v. Coler,* 178 U.S. 115 (1900). Yet in 1959 Congress also added a provision allowing estate taxes on Treasury securities.

III.

BECAUSE THE TENNESSEE BANK TAX IS AN INTANGIBLE PERSONAL PROPERTY TAX ON FARM CREDIT SECURITIES RATHER THAN A FRANCHISE TAX IT VIOLATES 12 U.S.C. §§ 2055, 2079, AND 2134, AND THE SUPREMACY CLAUSE OF THE CONSTITUTION

The Tennessee Bank Tax (T.C.A. § 67-751) is an intangible personal property tax. The parties so agreed in the Stipulation and the state tax statute specifically creates "a subclassification of intangible personal property." The Tennessee Bank Tax is clearly not a franchise or corporate excise tax, there being a separate franchise tax and a separate corporate excise imposed on all corporations, including banks, doing business in Tennessee. Because the Tennessee Bank Tax is not a franchise tax but rather is an intangible personal property tax that indirectly taxes the interest earned on Farm Credit Securities, it violates 12 U.S.C. sections 2055, 2079, and 2134, and is unconstitutional as a result of the Supremacy Clause, regardless of whether it is discriminatory. *See Macallen Co. v. Massachusetts,* 279 U.S. 620 (1929); *Federal Land Bank v. Crosland,* 261 U.S. 374 (1923); *Smith v. Kansas City Title & Trust Co.,* 255 U.S. 180 (1921). Because of the identity of position shared by Appellant and the Farm Credit Banks on this issue, and because this argument is comprehensively made in the Brief on the Merits of Appellant Memphis Bank & Trust Company, the Farm Credit Banks will avoid unnecessary duplication by relying on Appellant's Brief.

IV.

BECAUSE THE TENNESSEE BANK TAX DISCRIMINATES AGAINST FARM CREDIT SECURITIES IN FAVOR OF TENNESSEE SECURITIES, IT VIOLATES 12 U.S.C. §§ 2055, 2079, AND 2134, AND THE SUPREMACY CLAUSE OF THE CONSTITUTION

Even if the Tennessee Bank Tax is construed to be a franchise tax, it nevertheless is impermissible because it discriminates against Federal instrumentalities and violates 12 U.S.C. §§ 2055, 2079, and 2134 and the Supremacy Clause of the Constituiton. A dollar of interest earned by a Tennessee bank on Tennessee securities will not be taxed or included in the measure of the tax, whereas a dollar of interest earned by the same bank on Farm Credit Securities will be taxed or included in the measure of the tax. The Tennessee Bank Tax will be greater if the bank invests in Farm Credit Securities as opposed to Tennessee obligations. Thus, Tennessee banks could reduce their tax burden by selling Farm Credit Securities and purchasing securities issued by the State of Tennessee, and this clearly discriminates against the Farm Credit Banks, which are Federal instrumentalities. In *Schuylkill Trust Co. v. Pennsylvania,* 296 U.S. 113, 120 (1935) (*Schuylkill I*), this Court recognized that states cannot impose any tax, regardless of its nature, that discriminates against "United States bonds or other securities entitled to exemption because issued by federal instrumentalities" such as the Farm Credit Banks.

Again, because this argument is comprehensively made in the Brief on the Merits of Appellant Memphis Bank and Trust Company, the Farm Credit Banks will avoid unnecessary duplication by relying on Appellant's Brief.

CONCLUSION

For the reasons stated herein, the *amici* Farm Credit Banks respectfully urge this court to reverse the decision of the Supreme Court of Tennessee in *Memphis Bank and Trust Co. v. Garner*, 624 S. W. 2d 551 (1981).

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No. 81-1613

In the Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST COMPANY, APPELLANT

v.

RILEY C. GARNER, ET AL.

ON APPEAL FROM THE SUPREME COURT OF TENNESSEE

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING REVERSAL

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QUESTION PRESENTED

Whether the tax imposed on banks doing business in Tennessee by Section 67–751 of the Tennessee Code violates Revised Statutes, Section 3701 (31 U.S.C. 742) and Article VI of the United States Constitution to the extent that the tax discriminates against obligations of the United States and its instrumentalities.

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MEMPHIS BANK & TRUST COMPANY, APPELLANT

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ON APPEAL FROM THE SUPREME COURT OF TENNESSEE

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING REVERSAL

INTEREST OF THE UNITED STATES

The decision below upholds the validity of a Tennessee tax on the net earnings of banks doing business within the State. As administered, the tax discriminates against the obligations of the federal government by including interest from federal obligations within the tax base and excluding interest from obligations of the State of Tennessee and its political subdivisions. The tax preference accorded by the decision below to Tennessee obligations over federal obligations

puts the United States at a competitive disadvantage in the capital markets and forces the government to accept a greater discount on the sale of its obligations to produce an equivalent net return. These added costs are potentially substantial. We are advised by the Department of the Treasury that as of April 1982, commercial banks hold more than $76 billion in federal obligations. Hence, if all of the states imposed a similar bank tax, the United States would incur additional borrowing costs of approximately $280 million, assuming an interest rate of 12 %. Hence, the United States has an important interest in the outcome of this litigation.

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee (J.A. 75a–81a) is reported at 624 S.W. 2d 551. The oral opinion (J.A. 61a–68a) and order on judgment (J.A. 69a–71a) of the Chancery Court of Shelby County, Tennessee, are unreported.

JURISDICTION

The judgment of the Supreme Court of Tennessee (J.A. 74a) was entered on November 30, 1981. A notice of appeal to this Court (J.A. 82a–83a) was filed on February 5, 1982, and a jurisdictional statement was filed with this Court on March 1, 1982. This Court noted probable jurisdiction on April 26, 1982. The jurisdiction of this Court rests on 28 U.S.C. 1257(2).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Constitution of the United States:

Article I, Section 8, Clause 2:

> The Congress shall have Power * * * To borrow money on the credit of the United States;

Article VI, Clause 2:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby; any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Revised, Section Statutes Section 3701 (1878 ed.) (31 U.S.C. 742[1]), as amended to add the second sentence by the Act of Sept. 22, 1959, Pub. L. No. 86–346, 73 Stat. 622:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

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[1] Title 31 of the United States Code is unenacted. The opening phrase, "Except as otherwise provided by law," which appears in Section 742 of that Title, is not part of the statute.

Sections 67–751, 67–752, 67–2602, 67–2606, and 67–2704 of the Tenn. Code (Cum. Supp. 1981) are set forth in the Appendix, *infra*, 14–18.

STATEMENT

Appellant Memphis Bank & Trust Company is a banking association organized under the laws of the State of Tennessee, with its principal office in Memphis, Shelby County, Tennessee (J.A. 8a). Appellant brought this action in the Chancery Court of Shelby County, Tennessee, against the Trustee of Shelby County and the Treasurer of the City of Memphis, seeking to recover taxes for 1977 and 1978 assessed against it under Section 67–751 of the Tennessee Code, and paid under protest (J.A. 8a–12a, 18a–19a, 27a–31a). The Attorney General of Tennessee intervened as a defendant (J.A. 2a–3a, 24a–25a.)

Prior to 1977, Section 67–715 of the Tenn. Code (Cum. Supp 1981) imposed upon shareholders in "any bank or banking association, savings bank or loan company, or investment company", among others, an annual personal property tax on their shares of the stock of such organizations. By the Laws of 1977, ch. 140, Section 2, the Tennessee Legislature removed from Section 67–715 the words "bank or banking association, savings bank or." By Section 1 of that Act, the Tennessee Legislature added Sections 67–751 and 67–752 (Appendix, *infra*, 14–15) to the Tennessee Code, thereby imposing on the banks the new tax at issue here.[2]

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[2]The extended preamble and Section 1 of that Act are set forth at J.S. App. 35a–37a.

Section 67–751 is entitled "Excise tax on bank earnings—rate." It requires that each bank doing business in the state shall, beginning in 1977 and annually thereafter, "pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67." Chapter 27, Sections 67–2701 to 67–2732) imposed an existing excise tax on the net earnings of corporations, including banks, and Section 67–2704 of that chapter (Appendix, *infra*, 16–18) defined "net earnings" as "federal taxable income," with adjustments as set forth. Pursuant to 26 U.S.C. 103(a)(1), "federal taxable income" does not include interest on state or municipal obligations but, with very limited exceptions, does include interest on obligations of the United States and its instrumentalities. (See 26 U.S.C. 103.)

One of the adjustments to "federal taxable income" prescribed by the Tenn. Code § 67–2704 (Cum. Supp. 1981) is the addition of "[i]nterest income earned on bonds and other obligations of other states or their political subdivisions, less allowable amortization" (Section 67–2704(a)(2)). This adjustment does not include interest on obligations of the State of Tennessee or its political subdivisions, which remain excluded from the definition of "net earnings" subject to tax. Thus, on the face of these provisions of the Tennessee Code, banks such as appellant must include in their net earnings subject to the Tennessee tax interest on obligations of

the United States and its instrumentalities but not interest on obligations of the State of Tennessee and its subdivisions.

Appellant's complaint (J.A. 8a–17a) and amended complaints (J.A. 18a–19a, 27a–31a) alleged that the taxes on net earnings for 1977 and 1978 assessed against it under Section 67–751, which it paid under protest, included large amounts of interest on United States Treasury Notes and Bills, and on obligations of other agencies of the United States (Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives) in their computation of net earnings, in violation of 31 U.S.C. 742 and the United States Constitution. Appellant alleged that if those amounts had been excluded, it would have had no earnings subject to tax (J.A. 8a–17a, 18a–19a, 27a–31a).

The parties submitted the case to the Chancery Court of Shelby County on an agreed Stipulation of Facts (J.A. 36a–41a) and cross motions for summary judgment. In that stipulation, the parties agreed that the tax of $29,267.56 assessed against appellant for 1977, and based on statutory "net earnings" during 1976, was computed on the basis that appellant's "net earnings" were $1,389,522, and that that amount included interest of $928,219 from United States Treasury Notes, $216,984 from the United States Treasury Bills, $1,247,095 from obligations of Federal Land Banks, and $546,904 from Federal Intermediate Credit Banks. The parties also agreed (J.A. 39a, para. 7) that if those amounts of interest on federal obligations had been excluded, appellant's statutory "net earnings" would have been less than zero, so that appellant would

have had no Tennessee bank tax liability under the provision in question for 1977.

The parties further agreed that the tax of $27,429.25 assessed against appellant for 1978 on statutory "net earnings" during 1977, was computed on the basis that appellant's "net earnings" were $1,505,424, and included in that amount was interest of $804,262 from United States Treasury Notes, $44,536 from United States Treasury Bills, $1,625,602 from obligations of Federal Land Banks, $656,551 from Federal Intermediate Credit Banks, and $265,000 from Banks for Cooperatives. With respect to 1978, the parties further stipulated (J.A. 40a, para. 8) that if those amounts had been excluded, appellant's statutory "net earnings" would have been less than zero, and that appellant would have had no Tennessee bank tax liability under the statutory provision in question for 1978.[3]

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[3] We necessarily proceed on the basis of the facts to which the parties to this case have stipulated, and which the Chancery Court and the Supreme Court of Tennessee have accepted. On the face of the Tennessee statutes, however, it is not entirely clear that the statutes required the inclusion of interest on obligations of the United States, and of its instrumentalities, in "net earnings." As we have noted, Section 67-2704 defines "net earnings" in terms of "federal taxable income," with adjustments thereafter set forth. One of the adjustments, apparently not taken into account by the taxing authorities or the courts below, provides that "there shall be subtracted from federal taxable income: * * * (2) Any amount included in federal taxable income but not taxable under the law of this state." Section 67-2704(b)(2). Section 67-2602 (Appendix, *infra*, 15-16) imposes an income tax on income from dividends from stocks or interest on bonds. But Section 67-2606 (Appendix, *infra*, 16), entitled "Governmental securities exempt", provides that nothing in that provision "shall be construed or held to authorize the levy of an income tax on obligations of the United States,

The Chancery Court found that 31 U.S.C. 742 prohibited inclusion of interest on obligations of the United States in the computation of taxable "net earnings" under Section 67–751 (J.A. 62a), and that 12 U.S.C. 2055, 2079, and 2134 similarly prohibited inclusion of interest on obligations of Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives (J.A. 67a). It therefore upheld appellant's refund claim for taxes in the amounts of $29,267.56 and $27,429.25 that it had paid under protest for 1977 and 1978, respectively (J.A. 69a–70a).

The Supreme Court of Tennessee reversed and dismissed appellant's suit (J.A. 74a). It held that the tax imposed by Section 67–751 was a nondiscriminatory franchise tax that fell within the exception for such taxes set forth in (31 U.S.C. 742). It held that nothing

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whether evidenced by bonds or otherwise and/or on shares of stock in corporations which are arms and agencies directly of the United States, insofar as such bonds and stocks are exempt from such taxation by the Constitution or laws of the United States."

Since the income from the federal obligations owned by appellant could not be taxed by Tennessee (Revised Statutes, Section 3701 (1878 ed.); *Northwestern Mutual Life Insurance Co.* v. *Wisconsin*, 275 U.S. 136, 140 (1927)), it would appear that Section 67–2704(b)(2) calls for a resulting adjustment in the computation of "net earnings" that would eliminate interest on obligations of the United States and its instrumentalities. It remains clear, however, that the statute as administered by the Tennessee taxing authorities and applied in the courts below included such interest in the computation of taxable "net earnings." In the Tennessee Supreme Court, the brief for the appellant pointed out (Br. 30–31) that the conflict with federal law could be avoided by giving effect to Section 67–2606 as an adjustment under Section 67–2704(b), but the Tennessee Supreme Court ignored the argument.

in that provision, or in the United States Constitution, or in 12 U.S.C. 2055, 2079 or 2134 prevented inclusion of interest from obligations of the United States or of its instrumentalities in the measure of a franchise tax (J.A. 76a–81a).

SUMMARY OF ARGUMENT

The Tennessee bank tax discriminates against obligations of the United States and its instrumentalities and therefore violates the Supremacy Clause (Article VI) of the Constitution and Revised Statutes Section 3701 (1878 ed.) (31 U.S.C. 742). Under the Tennessee statutes, banks doing business in the State are subject to a tax on their net earnings that includes interest from federal government obligations but excludes interest on obligations of the State of Tennessee and its political subdivisions. Such a tax is invalid under the Supremacy Clause and contravenes the statutory exemption from state taxation of federal obligations, except nondiscriminatory franchise taxes. "* * * [I]t still remains true, as it has from the time of *M'Culloch* v. *Maryland*, 4 Wheat. 316, that a state tax may not discriminate against the Government or those with whom it deals." *Phillips Chemical Co.* v. *Dumas School District*, 361 U.S. 376, 387 (1960).

While the discriminatory aspect of the Tennessee tax appears to call for outright reversal, the courts below did not consider the operation of the Tennessee alternative minimum tax. Since it is not clear whether the alternative minimum tax would operate in a discriminatory fashion, the Court should remand the case for consideration of the alternative minimum tax imposed by Section 67–752 of the Tenn. Code (Cum. Supp. 1981).

ARGUMENT

THE TENNESSEE BANK TAX UNCONSTITUTIONALLY DISCRIMINATES AGAINST THE OBLIGATIONS OF THE UNITED STATES AND ITS INSTRUMENTALITIES

The Supreme Court of Tennessee upheld that Section 67–751 of the Tennessee Code applied in this case on the ground that it imposed a non-discriminatory franchise tax, and therefore was within the exception stated in Revised Statutes, Section 3701 (1878 ed.) (31 U.S.C. 742). The United States submits that the Tennessee taxing statute, as applied and upheld by the Supreme Court of Tennessee, discriminates against the obligations of the United States and its instrumentalities. Accordingly, whether the tax imposed by Section 67–751 is a franchise tax or is not a franchise tax, as appellant argues (J.S. 9–11), it is not a "*nondiscriminatory* franchise tax." Since interest on the obligations of the United States was, as stipulated, considered in the computation of the tax while interest on obligations of the State and its political subdivisions was excluded, the tax imposed by Section 67–751 violates Revised Statutes, Section 3701 and Article VI (the Supremacy Clause) of the Constitution.

This Court has consistently held that if a state imposes a tax on those who deal with the United States, or hold property or obligations of the United States, but exempts from the tax those who deal with the state, or hold property or obligations of the state or its subdivisions, the tax, though it might otherwise be permisssible, discriminates against the United States, and is unconstitutional. *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744 (1961); *Phillips Chemical*

Co. v. *Dumas School District*, 361 U.S. 376 (1960); *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 495 (1958); *Schuylkill Trust Co.* v. *Pennsylvania*, 296 U.S. 113 (1935). In *Phillips Chemical Co.*, the Court observed (361 U.S. at 387): "As we had occasion to state, quite recently, it still remains true, as it has from the time of *M'Culloch* v. *Maryland*, 4 Wheat. 316, that a state tax may not discriminate against the Government or those with whom it deals." Moreover, the Court has reaffirmed the validity of the nondiscrimination principle in a number of cases even when dealing with taxes that did not discriminate. See *United States* v. *County of Fresno*, 429 U.S. 452, 462 (1977); *United States* v. *New Mexico*, No. 80–702 (Mar. 24, 1982), slip op. 14 n.11.

Here, Tennessee included interest on obligations of the United States and of its instrumentalities in the computation of the taxes imposed by Section 67–751, but did not include interest on obligations of the state or its political subdivisions. It is therefore clear that the tax as applied is unconstitutional, and likewise contravenes the provisions of Revised Statutes, Section 3701. In these circumstances, it would ordinarily be appropriate to reverse the judgment of the Supreme Court of Tennessee, and to reinstate the judgment of the Chancery Court.

Although outright reversal might be appropriate, the courts below did not consider the operation of Section 67–752, Appendix, *infra* at 14, entitled "Minimum Tax," and enacted in conjunction with Section 67–751 (see J.S. App. 36a–37a). While that provision is based on property valuations, and reinforces the contention

that its companion Section 67–751 is a property tax rather than a franchise tax, it is not clear how Section 67–752 would operate. Even if it were considered a franchise tax measured by property rather than income, it is not clear that it would be sanctioned by Revised Statutes, Section 3701, since the exception there stated appears to assimilate franchise taxes only to nonproperty taxes. But beyond those questions, it is not clear whether Section 67–752 would operate in a discriminatory fashion. Sections 67–503[4], 67–504, and 67–505 of the Tennessee Code (1976 & Cum. Supp. 1981) exempt from taxation obligations of the State of Tennessee or any agency thereof, or of any county, town, or city, or agency thereof. Given those statutory exemptions, such obligations may also be excluded in computing the book value of a bank subject to tax pursuant to Section 67–752. And since no stated exemption or exclusion of obligations of the United States appears, it is entirely possible that Section 67–752, even if considered an alternative franchise tax, would be as discriminatory in its operation as Section 67–751. If Section 67–752 is not considered an alternative franchise tax, but an alternative property tax on capital, surplus, and undivided profits, then it is clear that obligations of the United States and of its instrumentalities must be excluded in the computation of the tax. *Society for Savings* v. *Bowers*, 349 U.S. 143 (1955); *New Jersey Realty Title Insurance Co.* v. *Division of Tax Appeals*, 338

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[4]As amended in 1977, Section 67–503 permits inheritance, transfer and estate taxes with respect to obligations of the state or any agency thereof.

U.S. 665 (1950); *Home Savings Bank* v. *Des Moines*, 205 U.S. 503 (1907); Revised Statutes, Section 3701. Since these alternative considerations relating to the minimum tax were not addressed by the courts below, we believe that a remand would be appropriate for consideration of these questions of state law. It is clear, however, that the judgment below upholding the tax as here applied was error.

CONCLUSION

The judgment of the Supreme Court of Tennessee should be reversed, and the case remanded for consideration of the alternative minimum tax imposed by Section 67–752 of the Tenn. Code.

Respectfully submitted.

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JULY 1982

APPENDIX

Tenn. Code (1976 & Cum. Supp. 1981):

67–751. Excise tax on bank earnings— Rate.— There is hereby created a subclassification if intangible personal property which shall be designated as the "shares of banks and banking associations." All property in the subclassification shall be taxed in the following manner: Commencing in 1977 and each year thereafter, in lieu of the assessment according to the value and taxation of its intangible personal property, each bank doing business in this state shall pay to local governments of Tennessee an excise tax of three percent (3%) of the net earnings for the next preceding fiscal year less ten percent (10%) of the ad valorem taxes paid by the bank on its real property and tangible personal property for the next preceding year. The net earnings shall be calculated in the same manner as prescribed by chapter 27 of title 67. The tax herein imposed shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, customer savings and checking accounts, certificates of deposit and certificates of investment, by whatever name called, including other intangible corporate property of such bank or banking association provided that such bank or banking association shall nonetheless continue to be subject to ad valorem taxes on its real and tangible personal property, the excise tax imposed under chapter 27 of title 67 and all other taxes to which it is currently subject. [Acts 1977, ch. 140, § 1.]

67–752. Minimum tax.—In no event shall the tax imposed under § 67–751 upon any bank be less than an ad valorem tax calculated on the basis of

sixty percent (60%) of the book value of the bank as of December 31, 1976 except that the sixty percent (60%) book value of any bank which has been in business for five (5) years or less shall be determined as of the first year such bank is in business and the sixty percent (60%) book value of the fifth year shall be used for the sixth year and all years thereafter. The book value of any bank shall be the sum of the paid in capital, surplus and undivided profits.

In determining the value to be assessed, the following shall be deducted from the sixty percent (60%) book value:

(1) The appraised value of all real property and tangible personal property otherwise owned and assessed to companies subject to this tax; and

(2) The appraised value of all real property in Tennessee occupied by companies subject to this tax and used for the purpose of conducting their business under a lease which provides that all ad valorem taxes on such property shall be paid by such companies and said lease has been registered in the county where such property is located.

The remaining value shall be assessed at forty percent (40%) and the resulting assessment shall be the amount to which the appropriate city and county tax rates shall be applied to determine the tax due and payable to the respective taxing jurisdicitons. [Acts 1977, ch. 140, § 1.]

67-2602. Incomes taxable—General rate.—An income tax in the amount of six percent (6%) per annum (except as provided in § 67-2603), shall be levied and collected on incomes derived by way of dividends from stocks or by way of interest on bonds of each person, partnership, association, trust and corporation in the state of Tennessee who

received, or to whom accrued, or to whom was credited during any year income from the sources above enumerated except as hereafter provided. [Acts 1931 (2nd E.S.), ch. 20, § 1; 1937, ch. 117, § 1; 1937, ch. 297, § 1; C. Supp. 1950, § 1123.1; modified; Acts 1967, ch. 176, § 2.]

67–2606. Governmental securities exempt.—Nothing contained in this chapter shall be construed or held to authorize the levy of an income tax on obligations of the United States, whether evidenced by bonds or otherwise and/or on shares of stock in corporations which are arms and agencies directly of the United States, insofar as such bonds and stocks are exempt from such taxation by the Constitution or laws of the United States; or on the income derived from bonds of the state of Tennessee, or any county or municipality or other political subdivision thereof not subject to ad valorem taxation. [Acts 1931 (2nd E.S.), ch. 20, § 4; 1933, ch. 60, § 2; C. Supp. 1950, § 1123.4.]

67–2704. "Net earnings" defined.—The term "net earnings" is defined as federal taxable income before the operating loss deduction and special deductions provided for in §§ 241 through 247 and 249 through 250 of the Internal Revenue Code as required to be reported by corporations under the Internal Revenue Code, subject to the following adjustments:

(a) There shall be added to the federal taxable income:

(1) Excise tax imposed by this state to the extent deducted in determining federal taxable income.

(2) Interest income earned on bonds and other obligations of other states or their political subdivisions less allowable amortization.

(3) Any deduction made pursuant to §§ 611–617 of the Internal Revenue Code to the extent the deduction when added with similar deductions in prior years exceeds the cost of the property.

(4) Gains not recognized pursuant to § 337 of the Internal Revenue Code.

(5) The charitable contributions deduction claimed under § 170 of the Internal Revenue Code.

(6) Any capital loss carrybacks or carryovers deducted pursuant to § 1212(a) of the Internal Revenue Code.

(b) There shall be subtracted from the federal taxable income:

(1) Dividends earned by a parent corporation from a subsidiary corporation where such parent owns eighty percent (80%) or more of the stock of the subsidiary.

(2) Any amount included in federal taxable income but not taxable under the law of this state.

(3) Any net operating loss incurred, which is defined as the excess of allowable deductions over total income allocable to this state for the year of the loss, and which may be carried over and allowed in succeeding tax years until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than three (3) years after the taxable year in which the net operating loss occurs.

(4) A portion of the gain or loss on the sale or other disposition of property having a higher basis for Tennessee excise tax purposes than federal income tax purposes measured by the difference in the Tennessee basis and the federal basis.

(5) Actual charitable contributions made by the corporation during the fiscal year.

(6) Losses not deducted pursuant to § 337 of the Internal Revenue Code.

(7) Any capital losses incurred during the fiscal year and not deductible under § 1211 (a) of the Internal Revenue Code.

(8) Any expense; other than income taxes, not deducted in determining federal taxable income for which a credit against the federal income tax is allowable. This subdivision shall apply to taxable periods ending on and after December 31, 1977. [Acts 1976 (Adj. S.), ch. 537, § 29; 1978 (Adj. S.), ch. 841, §§ 1, 2.]

Reply Brief

Supreme Court, U.S.
FILED
JUL 23 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

MEMPHIS BANK & TRUST CO., *Appellant*,

v.

RILEY C. GARNER, SHELBY COUNTY TRUSTEE,

and

GLENN E. FOSTER, TREASURER OF THE CITY OF MEMPHIS, TENNESSEE,

and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL FOR THE STATE OF TENNESSEE, *Appellees*.

On Appeal From The Supreme Court of Tennessee

APPELLEE'S RESPONSE TO MOTION FOR LEAVE TO FILE AMICI CURIAE BRIEF

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MEMPHIS BANK & TRUST CO., *Appellant*,

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and

WILLIAM M. LEECH, JR., ATTORNEY GENERAL
FOR THE STATE OF TENNESSEE, *Appellees*.

On Appeal From The Supreme Court of Tennessee

APPELLEE'S RESPONSE TO MOTION FOR LEAVE TO FILE AMICI CURIAE BRIEF

Appellees hereby file objection to the motion by Capital Preservation Fund, Inc., and Sandra L. Brown for leave to file a brief *amici curiae*. Appellees' objection is based on the following grounds:

1. The interest of Capital Preservation Fund, Inc., and Sandra L. Brown, as disclosed in the motion, does not concern the exception for franchise taxes provided in 31 U.S.C. § 742 and, thus, said interest is no more than a remote interest in the issues actually involved in this litigation. The tax statute applicable to Capital Preserva-

tion Fund, Inc., and Ms. Sandra L. Brown is a personal income tax and not a franchise tax on the privilege of doing business in the corporation form.

2. The issues which Capital Preservation Fund, Inc., and Sandra L. Brown seek to discuss in the proposed brief *amici curiae* are collateral to the issues actually involved in this proceeding (*i.e.*, the scope of the exception provided for franchise taxes in 31 U.S.C. § 742). For the parties to be put in the position of having to respond to the arguments of Capital Preservation Fund, Inc., and Sandra L. Brown on the collateral issues would unnecessarily cause the briefs to be enlarged and would be likely to distract both counsel and the Court from the issues actually involved.

3. Appellees submit that taxing statutes of different types should be treated separately since their attributes may vary considerably. Since Capital Preservation Fund, Inc., and Sandra L. Brown are not contesting a franchise tax and, thus, concerned with the application of 31 U.S.C. § 742, the Appellees believe that the allowance of the filing of this brief unnecessarily complicates and blurs the focus of this appeal.

For each and all of the foregoing reasons, the Motion for Leave to File Amici Curiae Brief of Capital Preservation Fund, Inc., and Sandra L. Brown should be denied.

Respectfully submitted,

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Docket Sheet

NO. 81-1613-ASX	TITLE Memphis Bank & Trust Company, Appellant v. Riley C. Garner, Shelby County Trustee, et al.

DOCKETED	COURT
Mar. 1, 1982	Supreme Court of Tennessee, Western Division

DATE	PROCEEDINGS AND ORDERS
	Counsel for Appellant: K. Martin Worthy
	Counsel for Appellees: Clifford D. Pierce, Jr., J. Minor Tait, Jr., Joe C. Peel,
Mar. 1, 1982	Statement as to jurisdiction filed. (Record filed).
Mar. 29, 1982	Motion of appellees Riley C. Garner and Glenn E. Foster to dismiss or affirm filed.
Mar. 31, 1982	Motion of the Attorney General of the State of Tennessee to dismiss or affirm filed.
Mar. 31, 1982	DISTRIBUTED. 4-16.
Apr. 14, 1982	Reply brief for the appellant filed. (D).
Apr. 20, 1982	REDISTRIBUTED. 4-23.
Apr. 26, 1982	Probable jurisdiction NOTED.

May 28, 1982	Order extending time to file the joint appendix and appellant's brief on the merits until July 10, 1982.
July 7, 1982	Order further extending time to file the joint appendix and appellant's brief on the merits until July 20, 1982.
July 9, 1982	Motion of Capital Preservation Fund, Inc., et al. for leave to file a brief as amici curiae filed.
July 16, 1982	Brief, amicus curiae, for the U. S. filed.
July 20, 1982	Brief for the appellant filed.
July 20, 1982	Joint appendix filed.
July 19, 1982	Motion of The Farm Credit Banks for leave to file a brief as amici curiae filed.
July 23, 1982	Appellee's objection to Motion of Capital Preservation Fund, Inc., et al. for leave to file a brief as amici curiae filed.
Aug. 2, 1982	Motion of appellees for divided argument filed.
Aug. 6, 1982	Order extending time to file the appellees' briefs on the merits until Sept. 20, 1982.
Sept. 9, 1982	The motion of Capital Preservation Fund, Inc. et al. for leave to file a brief as amici curiae is GRANTED. The motion of The Farm Credit Banks for leave to file a brief as amici curiae is GRANTED.
Sept. 8, 1982	Order extending time to file the appellees' brief on the merits until Oct. 4, 1982.
Oct. 4, 1982	The motion of appellees for divided argument is GRANTED.
	(Over)

81-1613

No.

Title

DATE	PROCEEDINGS AND ORDERS
Oct. 4, 1982	Brief of appellees, Riley C. Garner, et al. filed.
Oct. 6, 1982	Brief of appellee, William M. Leech, Jr., Attorney General of Tenneessee filed.
Oct. 13, 1982	CIRCULATED.
Nov. 22, 1982	Reply brief for the appellant filed. (D).
Nov. 29, 1982	ARGUED.